Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Revisions to Cable Television Rate Regulations	)	MB Docket No. 02-144
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 92-266
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 93-215
Adoption of a Uniform Accounting System for the Provision of Regulated Cable Service	)	CS Docket No. 94-28
Cable Pricing Flexibility	)	CS Docket No. 96-157

COMMENTS OF THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS, THE NATIONAL LEAGUE OF CITIES, AND THE MIAMI VALLEY CABLE COUNCIL

Nicholas P. Miller
Frederick E. Ellrod III
Mitsuko R. Herrera
Miller & Van Eaton, P.L.L.C.
1155 Connecticut Avenue, N.W. #1000
Washington, D.C. 20036-4306
202-785-0600
Counsel for the National Association of Telecommunications Officers and Advisors, the National League Of Cities, and the Miami Valley Cable Council

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EXHIBIT 1

SUMMARY

The Commission's current rate rules do not work. The rules are difficult and expensive to enforce, and even where they are enforced, they do not have the effect Congress directed the Commission to achieve: holding rates to reasonable levels for consumers. These Comments focus on certain selected areas in which the rules could be improved. Principal recommendations include:

- Reaffirm that cable operators must comply with local rate orders unless and until those orders are stayed or reversed. (II.B.1)
- Establish straightforward fines or forfeitures for enforcement. (II.B.2)
- Allow actual competitive rates to be used as a standard for setting nearby non-competitive rates. (II.B.3)
- Proactively investigate and sanction evasions of the rate rules. (II.B.4)
- Proactively investigate anticompetitive practices by cable operators. (II.B.5)
- Provide for funding for implementation of the Commission's rules by local communities. (II.B.6)
- Require that a demonstration of effective competition show that all subscribers in the area to be declared competitive actually have competitive alternatives; that the programming offered is in fact comparable in content to the basic cable tier; and that the operator has verified the necessary data. (III.B)
- Decline to find effective competition based solely on DBS. (III.B)
- Require effective competition petitions to be submitted to the local franchising authority, which will submit them to the Commission with its comments. (III.B)

- Clarify that, programming costs aside, moving a channel out of (or into) the basic tier means moving that channel's *pro rata* share of the residual. (IV.B)
- Require that an operator that is found to have misapplied the Commission's rules must go back and correct that error in every rate filing containing that error. (IV.B)
- Review aggregate equipment filings at the Commission level, or through a third-party accountant directed by the Commission with input from local franchising authorities. (V.B)
- Clearly reject sampling techniques used by cable operators in place of true aggregate data, or else specify the proper methodology for such sampling. (V.B)
- Make explicit rules to prohibit practices by incumbents that stifle competition, covering single-family residential subscribers as well as MDUs. (VI.B)
- Clarify that operators must charge the same rates to commercial as to residential subscribers, unless and until the Commission adopts separate regulated rates for commercial subscribers consistent with the statute. (VII.B)
- Permit any subscriber who has been discriminated against on "commercial rate" grounds to file a complaint directly with the Commission for relief, or alternatively with the local franchising authority. (VII.B)

The above recommendations are designed to address the following problems discussed in these Comments.

In General. The statute requires the Commission to protect subscribers by ensuring that basic rates are reasonable, *i.e.*, equivalent to what *would* be charged if there were real competition. The Commission is to work with local communities as co-regulators and must make rules to prevent evasions by cable operators. Yet cable rates remain unreasonable. They are not constrained to reasonable levels by alleged competition from DBS.

The Commission's rules do not fulfill the intent of Congress. In many cases they actually yield a maximum permitted rate *higher than the monopoly rate*, which proves that the rules are not generating reasonable (that is, competitive) rates. The rules have developed loopholes and defects over time. They are unnecessarily time-consuming and expensive for local communities to apply. The Commission has failed to prevent evasions; in fact, some of its past decisions actually encourage and reward evasions.

Effective Competition. The Commission's rules allow effective competition to be declared where it does not really exist. This occurs when two operators divide an overlapping franchise area between them. It also occurs when the Commission accepts without investigation unverified data on DBS "competition," to which local communities do not have access, despite the Commission's finding that the presence of DBS alone does not necessarily produce reasonable rates. Finally, the Commission has at times accepted possible future competition as if it were the real thing.

Channel Movement. Cable operators have sought to take advantage of alleged ambiguities in the Commission's rules to continue charging basic subscribers for channels even after those channels have been removed from the basic tier. The Commission's June, 2002 ruling appeared to resolve this issue, but was amended in such a way as to perpetuate confusion and possibly to permit evasion. The Commission should not allow cable operators' errors in applying the rules to stand, even if such errors may have been made in good faith.

Aggregated Equipment Rates. The 1996 Act allowed cable operators to use aggregate costs to arrive at equipment rates, rather than costs specific to the franchise area. But the

Commission's implementation allowed operators to aggregate in such a way as to impede review by local franchising authorities. In some cases this has resulted in significantly higher rates for equipment under the aggregation rules. The Commission did not decisively enforce its rules to prevent the use of "sampling" techniques instead of aggregation or to ensure that operators supplied the data necessary to allow local communities to verify their rates.

Uniform Rates. The Commission has applied the statutory requirement for uniform rates only on a franchise area basis. This allows cable operators to charge supracompetitive rates in monopoly areas while reducing rates where there is real competition. The Commission can, however, determine effective competition and apply its rate rules in those areas where subscribers lack a choice of cable providers, even if such an area is only part of a franchise area, and thus move toward effecting the purposes of Congress.

Commercial Rates. The statute directs the Commission to protect "subscribers" from unreasonable rates, without distinguishing between residential and commercial subscribers. Thus the Commission's rules make no provision for separate, higher rates for "commercial" subscribers. But the Commission's inaction on this issue has allowed cable operators to discriminate among subscribers based on whether the operator considers a given subscriber's use "commercial."

If the Commission does not enforce sound rate rules, rates *will* be unreasonable. Thus the statutory mandate means that the Commission must take affirmative steps to stop evasions and to make sure its rules work as they should. The Commission may not, consistent with its legal obligations, permit its rules to be misused or abused.

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1155 Connecticut Avenue, N.W. #1000
Washington, D.C. 20036-4306
202-785-0600
Counsel for the National Association of Telecommunications Officers and Advisors, the National League Of Cities, and the Miami Valley Cable Council

The National Association of Telecommunications Officers and Advisors; the National League of Cities; and the Miami Valley Cable Council (regulating rates for the cities of Centerville, Germantown, Kettering, Miamisburg, Moraine, Oakwood, Springboro and West Carrollton) (collectively, the Local Government Coalition) hereby submit the following comments in response to the Commission's above-captioned Notice of Proposed Rulemaking and Order, FCC 02-177, released June 19, 2002 ("*NPRM&O*").[1]

I. INTRODUCTION

A. Rate Regulation Is Necessary to Protect Consumers.

Rate regulation is an unfortunate necessity, like visiting the dentist. As the statutory provision indicates, it is never the first choice for dealing with the problem of unreasonably high cable rates. All agree that the best way to keep rates reasonable, in a perfect world, would be a robust competitive market.[2] A regulatory regimen that seeks to emulate what a competitive market would produce, by comparison, is at best a poor substitute.

Nonetheless, just as with going to the dentist, it does no good to put off the need to address the problem, or pretend the visit isn't necessary. Denying the problem of excessive rates will not make it go away. Wishful thinking about competition will not hold rates to competitive levels. It is necessary to confront the issues and deal with them effectively.

From this perspective the salient fact about the Commission's current rate rules is this: they don't work. The rules are difficult and expensive to enforce. Even where they are enforced,

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[1] In an Order under the same caption, 17 FCC Rcd. 15,974, released Aug. 14, 2002 ("*Amending Order*"), the Commission revised paragraph 55 of the *NPRM&O*. Unless otherwise indicated, these Comments apply to the *NPRM&O* as amended.

they do not have the intended effect of holding rates to reasonable levels for consumers. It is true that in some cases – particularly with respect to equipment – rates have been restrained to some degree. But in many other cases the calculated FCC rate is actually higher than the monopoly market rate – a sure sign that the rules do not work as Congress intended.

These comments do not seek merely to complain about the problems with the current regulatory scheme. Rather, they seek to offer certain specific suggestions that could be used to improve the Commission's rules. At the same time, these comments do not purport to provide an exhaustive account of all the loopholes, missteps, confusions, and other failings that prevent the rules from doing their job. Instead, they attempt to target particular issues that have particularly bedeviled local franchising authorities and consumers. There are many more issues that could be addressed, if time and cost permitted.[3] It is strongly recommended that the Commission listen to consumer groups and other non-industry commenters to identify additional problems affecting the consumers Congress wrote the law to protect.[4]

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[2] *Cf.* 47 U.S.C. § 543(a)(2) (titled "Preference for competition").

[3] For example, the Commission's unwillingness to consider the enormous revenues cable operators earn from advertising, or the inconsistent accounting techniques used to avoid offsetting "launch fee" revenues from program providers, should be addressed if the Commission seeks a serious reform of its rate rules.

[4] *See, e.g.*, Chris Murray, Gene Kimmelman & Dr. Mark Cooper, Consumers Union, *Abusing Consumers and Impeding Competition: The State of the Cable Television Industry*, July 24, 2002, *available at* http://www.consumersunion.org/pdf/cable2002.pdf (last visited 10/21/02); Letter from Hon. John McCain, United States Senator, to Hon. Michael Powell, Chairman, Federal Communications Commission (April 16, 2002), *available at* http://mccain.senate.gov/cablerates02.htm (last visited 10/21/02); and Letter from Hon. John McCain, United States Senator, to Hon. David M. Walker, Comptroller General, U.S. General Accounting Office (April 16, 2002), *available at* http://mccain.senate.gov/cablerates02.htm (last visited 10/21/02) ("*McCain GAO Letter*"); *In re Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82, Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital

B. Congress Intended the Rate Rules to Protect Consumers.

At this distance in time from the original establishment of the rate rules, it is useful to recall their purpose and intent.

In 1992, Congress found that since rate deregulation in 1984, cable rates had increased at almost three times the rate of the Consumer Price Index – a net increase even when increased channel numbers were taken into account. Congress found that this increase was due to the market power wielded by cable operators, who generally possessed *de facto* monopolies.[5] Deregulation in 1984 had relied on the promise of competition to restrain rates. That promise had not been fulfilled. Congress recognized that, while competition for cable should be encouraged, it would be irresponsible to leave consumers at the mercy of cable operators' market power while "waiting for Godot" in the form of the anticipated era of full competition.

Accordingly, Congress reinstituted cable rate regulation for basic and "cable programming service" ("CPS") tiers of service and related equipment.[6] Congress relied heavily on the Commission's expertise and careful oversight to achieve the goal of protecting consumers from excessive prices. Placing all its rate-setting eggs in one basket, Congress set the Commission the task of making the rules that would govern both basic and (at that time) CPS rates. The Commission was instructed not merely to curb the more excessive practices of cable operators, but to *ensure* that basic rates *were reasonable.*

(1) Commission obligation to subscribers

Democracy, and Media Access Project, to Further Notice of Proposed Rulemaking (Feb. 19, 2002).

[5] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460, § 2(a)(1)(2) (1992).

[6] Regulation of the CPS tier was later terminated by the Telecommunications Act of 1996 ("1996 Act") as of March 31, 1999. *See* 47 U.S.C. § 543(c)(4).

> The Commission shall, by regulation, ensure that the rates for the basic service tier are reasonable. Such regulations shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition.[7]

It is of the highest importance that Congress expressly placed the Commission under an "*obligation to subscribers*." The focus of rate regulation is on protecting subscribers, not cable operators. The Commission fails to obey this statutory mandate if it allows any unreasonable basic rates: the mandate is to *ensure* that rates are reasonable. And the standard for reasonableness is what *would* be charged if there were real competition facing incumbent cable operators.

At the same time, Congress provided for local governments to conduct the actual business of regulating basic cable rates, pursuant to the Commission's rules.[8] Congress thus made local authorities *co-regulators* with the Commission in this endeavor. While the Commission was to have the final say in determining the meaning of its rules (read in light of the statutory goal of protecting subscribers), it was assumed that the FCC would work together with local communities in enforcing those rules and achieving that goal. Under the federal law, a local franchising authority appearing before the Commission on a rate appeal is not merely a litigant standing on equal terms with the protesting cable operator. Rather, the local community is coequal with the Commission, a partner in the same effort.

Nor did Congress intend the Commission merely to create rules and then walk away, leaving their enforcement to the unaided efforts of local communities. Rather, Congress took the

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[7] 47 U.S.C. § 543(b)(1).

[8] *See* 47 U.S.C. § 543(b)(5)(A).

trouble to issue specific instructions for the Commission to prevent cable operators from circumventing the rules.

> Within 180 days after October 5, 1992, the Commission shall, by regulation, establish standards, guidelines, and procedures to prevent evasions, including evasions that result from retiering, of the requirements of this section and shall, thereafter, periodically review and revise such standards, guidelines, and procedures.[9]

Thus, this proceeding, instituted by the Commission in June of 2002, almost ten years after Congress issued the above mandate, is a step in the right direction. It is not clear whether one could identify any past regulations that responded specifically to this specific congressional call for action. But the Commission has now created an opportunity to cure some of the evasions that have so often vitiated the existing rules. If the Commission is to comply with the congressional mandate, it must take this opportunity to prevent evasions and improve the performance of its rules in preventing unreasonable rates – not to further weaken its rules or create new loopholes for evasion.

II. THE COMMISSION'S RATE RULES HAVE FAILED TO PREVENT UNREASONABLE RATES.

This section speaks generally to the fact that the Commission's rules have failed to keep rates reasonable, and identifies a few of the reasons for that disappointing result. The recommendations that follow this critique seek to provide suggestions for some general ways in which the Commission could reform its rules to make them more effective in carrying out the mandate of Congress.

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[9] 47 U.S.C. § 543(h).

A. Problem

1. Ten Years Later, Rates Are Still Unreasonable.

The simple fact is that cable rates are still unreasonably high and still reflect the market power enjoyed by almost all cable operators. This fact has been recognized in Congress:

> They [cable subscribers] continue to endure rate increases that outstrip, by many multitudes, the price increases of other consumer goods and services. . . . Why does there continue to be a 6.3% differential in monthly cable rates between competitive and noncompetitive cable operators?[10]

This congressional concern is well-founded. Since the passage of the 1996 Act, cable rates have risen on the average by 35.7 percent, while the Consumer Price Index has gone up only 14.5 percent.[11] The cable CPI increased 3.9% for the 12 months ending July 2001.[12] By contrast, in January 2002, cable operator announced among others the following specific and average rate increases:[13]

• AT&T Broadband	5.5%
• Time Warner Cable	5%
• Comcast	5.5% to 6.4%[14]
• Charter	5% to 10%

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[10] *McCain GAO Letter* at 1.

[11] Brigitte Greenberg, *Cable Prices Rise More Than Other Goods and Services*, Communications Daily, Jan. 15, 2002, at 6.

[12] *2001 Competition Report* at ¶ 22, n.26. The Bureau of Labor and Statistics publishes a price index for cable services ("cable CPI") as a sub-component of the overall consumer price index. The cable CPI includes equipment, all program services (including premium services) and installation costs, and is adjusted for improvements in quality. That is, the addition of channels is usually interpreted by BLS as an improvement in quality, so BLS will likely increase an observed price when channels are added.

[13] *Cable Prices Rise More Than Other Goods and Services* at 6.

[14] Comcast did not release national averages, but acknowledges rate increases in Washington, DC and Baltimore, MD of 5.5% and 6.4% respectively.

- Cox 5.3%[15]
- Cablevision 5.5%[16]
- Mediacom 5% to 7%
- Cable One 5%

These facts do not necessarily indicate that the Commission's rules have been wholly ineffective. It is plausible to conclude that certain cable rates are in fact lower than they would have been in the absence of any regulation at all. At the same time, however, it is clear that the rules have not achieved Congress' goal of ensuring reasonable rates – which is to say, those that would have obtained under real competition.

It is often alleged that the presence of satellite video providers must be subjecting cable operators to competition.[17] However, the plain fact is that the presence of DBS, encouraging though it is, has not been sufficient to bring about competitive rates. This is evidenced, among other things, by the fact that there is still a differential between rates where an operator faces real wireline competition from another cable company, and rates where it does not.[18] If DBS

[15] New Orleans, LA and Santa Barbara, CA.

[16] New York Metropolitan Area.

[17] *See, e.g.*, *In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, CS Docket No. 01-129, Comments of the National Cable & Telecommunications Association to the Notice of Inquiry, at 9 (filed Aug. 2, 2001) (suggesting that the Commission declare effective competition in 40 states where statewide DBS penetration is claimed to exceed 15%).

[18] Where a cable system faces competition from DBS, there is no difference in rates as compared to noncompetitive systems. *Id.* at 10. On the other hand, where a system faces competition from another wireline cable provider or a LEC, the average monthly rate is $3.03 and $2.10 less than noncompetitive system rates.

competition were sufficient to ensure reasonable rates, there would be little if any difference – all areas would be equally competitive. In fact, that is not the case.[19]

As noted above, under the instructions of Congress, the FCC's rate rules were to correct this problem. They have not. Indeed, the rate rules are sufficiently porous – provided with enough loopholes permitting cable operators to evade the requirement of reasonable rates – that in many locations around the country, the maximum permitted rate ("MPR") calculated under the Commission's rules actually exceeds the monopoly market rate charged by the cable operator. For example:

Community	MPR	OSR
Redondo Beach, CA	$35.06	$30.19
Ramsey/Washington Counties Suburban Cable Communications Commission, MN[20]	$11.80	$9.84
North Suburban Communications Commission, MN	$10.61	$8.80
Quad Cities Cable Commission, MN	$9.43	$8.86
St. Louis, MO	$11.28	$10.74

This paradox is worth underlining: In a market where a single cable operator does not face competition and hence wields market power, it will charge the monopoly rate – in the vernacular, "all the market will bear." If the Commission's MPR is higher than that rate, then we are dealing with a set of rules that yield *higher than monopoly rates* – under color of replicating the *competitive* rate. Every case where a cable operator without a wireline competitor charges

[19] The Commission recently found: "Our price equation shows that the presence of a wireline overbuilder has a negative effect on cable rates. However, based on our limited data, the presence of effective competition due to DBS overbuild status has no significant effect on cable rates." *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of* 1992, Report on Cable Industry Prices, 17 FCC Rcd. 6301, ¶ 45 (2002) (*"2002 Competition Report"*).

[20] For nine of the ten cities served by this joint regulatory authority. In the other city, the MPR is $11.69 rather than $11.80; the OSR is still $9.84.

less than the MPR represents a case where the Commission's rules fail so completely that, far from producing reasonable rates, they generate maximum permitted rates so high that even a monopolist cannot get people to pay them.

2. The Commission's Rules Have Degraded Over Time.

In some cases what began as a well-intentioned rule has been eroded by exceptions, qualifications, or outright reversals of direction that rob it of its intended effect. This is not a universal trend: there have been cases where the Commission made an inadequate rule and later corrected it.[21] But all too often, the reverse has been true. For example, the Commission originally reached a reasonable conclusion that a special pass-through was not necessary to encourage cable operators to upgrade their networks; the increased revenue from the improved facilities would provide that encouragement in a market-based fashion.[22] Later, however, the

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[21] For example, the original Form 393 rate reduction was capped at ten percent; six months later, the Form 1200 calculation increased the potential reduction to seventeen percent. *See In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd. 5631, ¶ 14 & n.29 (1993) ("*Rate Order*"); *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, 9 FCC Rcd. 4119, ¶ 19 (1994) ("*Second Reconsideration Order*"); *Overview of Revised Cable Benchmark Regulations*, March 30, 1994, at 1-2 (on file with NATOA). Similarly, the Commission originally sought to create a nationwide rule to deal with documents claimed to be confidential; then, recognizing that communities in different states were unavoidably governed by different state laws, revised the rule to take account of state law. *See* Rate Order at ¶ 89 & n.349; this approach was revised in *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation – Buy-Through Prohibition*, Third Order on Reconsideration, 9 FCC Rcd. 4316, ¶ 79 (1994) ("*Third Reconsideration Order*").

[22] *See, e.g.*, Rate Order at ¶ 256 & n.608; *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, 9 FCC Rcd. 1164, ¶ 97 (1993) ("*First Reconsideration Order*").

Commission retreated from this position and allowed a special pass-through filing for network upgrades.[23]

The same result flowed from the Commission's "social contracts," in which cable operators were allowed to command permanent increases over the FCC-calculated maximum permitted rates in exchange for benefits which by their terms had only a limited life at best. For example, in a set of municipalities in St. Louis County, Missouri, the 1995 Commission deal with Continental Cablevision required a "lifeline basic" tier at a rate then set at $6.50.[24] The region is now looking at a 2003 rate increase that eliminates the lifeline tier and charges $12.00 for basic.[25]

This process illustrates a frequent problem with the rules as they have developed. Not only does this "one step forward and two steps back" approach erode the effect of an originally sensible rule; in addition, the layering of a special correction or exception on top of the existing rule gives rise to an extraordinarily complicated structure. This makes rate regulation so difficult that the ordinary layperson is unable to comprehend it; creates complexities and ambiguities that

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[23] *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, Report and Order and Further Notice of Proposed Rulemaking, 9 FCC Rcd. 4527, ¶¶ 280-291 (1994) ("*Cost of Service Order*"). The *NPRM&O* asks for comment on this issue at ¶¶ 36-37. While it seems clear that such an upgrade pass-through is unnecessary, these comments do not address that issue in detail.

[24] *See In re Social Contract for Continental Cablevision*, Memorandum Opinion and Order, 11 FCC Rcd. 2788, ¶ 44 (1995) ("*FCC-Continental Order*"); attached "Social Contract for Continental Cablevision, Inc." at § III.B. For ease of comparison with the MPR calculated on the Commission's forms, rates will generally be stated herein exclusive of franchise fees, which are, however, part of the rate.

[25] The Commission refused to make available to local franchising authorities the analyses that led to the Commission's acceptance of this deal with Continental. *See FCC-Continental Order* at ¶ 3 n.7. The Continental system in St. Louis County was bought in 1996 by TCI,

unnecessarily generate fruitless lawyers' arguments; and often falls victim to the "law of unintended consequences" in which the rules produce unexpected and unwelcome results simply because no one fully understood the combined effect of the various "corrections."[26]

3. The Commission's Rules Make the Review Process Unnecessarily Time-Consuming and Expensive.

This progressive complication of the Commission's rules over time intensifies another problem. The Commission's regulatory scheme takes too long to apply and is too costly for many franchising authorities to engage in. Even from the beginning, the Commission's methodology proved daunting for smaller communities – those without staffs of financial analysts.[27] As the rules became more complicated, epicycles piled on epicycles, it quickly became evident that only a specialized expert could hope to determine "where the bodies were buried" in a cable operator's rate filing. The result has been that many small communities have been priced out of the rate regulation market.[28]

Since the congressional plan for rate regulation relies on local communities to implement the Commission's rules, this problem with the workability of the Commission's rules has had a

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operated by AT&T Broadband after the latter's acquisition of TCI, then transferred to Charter in 2001.

[26] *See, e.g.*, the channel movement rules discussed in detail in Section IV *infra*.

[27] It is a matter of considerable concern that the Commission, in complying with the mandate of the Regulatory Flexibility Act to evaluate the impact of its rules on small entities, has consistently ignored the impact on small *communities* and focused exclusively on the impact on small *cable operators*. In the *NPRM&O*, for example, the Commission notes once – at paragraph 62 – that the RFA's "small entities" include the "small governmental jurisdiction," and then proceeds to ignore small governmental jurisdictions entirely throughout its four-and-a-half-page impact analysis.

[28] For example, one local franchising authority had to spend over $26,000 in 2001 to complete a rate review – much of it in extracting the necessary supporting information from the

substantive effect in reducing the effectiveness of basic rate regulation. Indeed, had Congress known how the Commission would implement its statutory directive, it might well have needed to consider the effect of the Unfunded Mandates Reform Act of 1995,[29] which forbids the federal government to commandeer local property or local decision-makers for federal purposes. The burden placed on local resources by the Commission's rules is particularly problematic given that those rules do not even achieve those federal purposes, as pointed out above.

4. The Commission Has Failed to Make Rules or Take Other Steps to Prevent Evasions.

Perhaps the most damaging failure in the ten-year history of Commission rate regulation has been the apparent absence of any attempt to comply with the congressional mandate to prevent evasions. Not only has the Commission taken no discernible steps to stop evasions: on the contrary, in many cases the Commission has taken steps that positively encouraged evasions.

A recent example may be found in the *NPRM&O* itself (and is discussed in more detail in Section IV below). The cable industry's attempt to move channels out of the basic tier *while continuing to charge basic subscribers for a portion of their costs* can most charitably be described as a dogged attempt to take advantage of an alleged technical error by the Commission in drafting a "sunset" provision. The position taken in at least some industry filings makes no substantive sense and cannot have been adopted in good faith. The Commission responded to this problem by issuing a "clarification" in paragraph 55 (the "Order" part) of the *NPRM&O*. The clarification appeared to make clear that a cable operator could *not* continue charging for an absent channel. Yet the Commission then spontaneously issued a revision to its clarification,

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cable operator and debating with the operator the proper application of the Commission's rules. Such costs may be trivial for major MSOs, but they are significant for local communities.

[29] Pub. L. No. 104-4, 109 Stat. 48, *codified* at 2 U.S.C. §§ 1501 *ff*. (1995).

two months later, whose purpose (to the extent it can be discerned from the somewhat confusing text) appears to be to allow cable operators to "get away with" such charges in some cases.[30] The message this sends to cable operators is: If you can think of a clever way to defeat our rules, we'll let you have it. The effect of this message over the last ten years has not been salubrious.

The classic example of rewarding evasions dates back to the "à la carte tier" controversy of 1994. When the initial rate rules were introduced, they exempted single-channel "à la carte" offerings. Some cable operators then created special tiers whose individual channels were ostensibly available à la carte, but priced the individual channels at so high a level compared to the entire tier that it would have been ludicrous for anyone to purchase the channels separately (and in fact, almost no one did so). Because the channels were theoretically available à la carte, the operators claimed that such tiers were unregulated. (Moreover, because of the way channels were counted in the benchmark formulae, excluding these channels from regulation *also* increased the MPR for the *other* tiers.)

In the face of this patently evasive tactic, the Commission took a remarkable step. In a series of orders issued on November 18, 1994, the Commission found that the "à la carte tiers" avoided the application of rate regulation, and moreover that "there appears to be no sufficient justification for [the operator's] restructuring other than to avoid rate regulation."[31] In other words, this was not a good-faith attempt to apply the Commission's rules: it was a tactic with *no other justification* than evasion. Yet, the Commission did not sanction the operators for the evasive tactics. Astonishingly, the Commission did not even reverse the evasion itself and apply

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[30] *Amending Order* at ¶ 2.

[31] *In the Matter of Comcast Cablevision City of Tallahassee, Florida, Letter of Inquiry*, Memorandum Opinion and Order, 9 FCC Rcd. 7773, ¶ 15 (1994). The full Commission

its rules as they had been intended to apply. Instead, on the grounds that the operators *might conceivably have believed* that their tactic was permissible under the rules, the Commission *approved* the tactic and allowed the ersatz à la carte tiers to remain unregulated.[32]

Thus, rather than applying its rules so as to ensure subscribers reasonable rates, as Congress demanded, the Commission applied a wholly inappropriate standard of intent, as if the correction of a rate to reasonable levels were a penal judgment against the operator. The net effect was that those operators who had tried the evasion actually gained ground over those who had not. The ersatz à la carte tiers were exempted from regulation without having to meet the standards applied for similar tiers later proposed by other operators. The clear message taken by the industry was: Unless an operator's filing was actually marked "THIS IS AN EVASION" in large block letters, the Commission would take for granted that any noncompliance was an honest mistake, even in the teeth of contrary evidence – and, instead of correcting the mistake, *perpetuate* it. A more striking way of rewarding evasions could hardly be imagined.

Such examples could be multiplied.[33] But two points are worthy of special note. Both bear on the fact the Commission has failed to take any steps that would, as a practical matter, require cable operators to comply with local rate orders.

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affirmed this approach. *See In re Comcast Cablevision City of Tallahassee, Florida, Letter of Inquiry, Application for Review*, Memorandum Opinion and Order, 11 FCC Rcd. 1246 (1995).

[32] In most cases. The Bureau applied a cutoff at six channels: a pseudo-tier with six or fewer channels was "canonized" as a "new product tier"; a pseudo-tier with seven or more was not approved. *See, e.g., In the Matter of: Adelphia Cable Partners, L.P., South Dade County, Florida, Letter of* Inquiry, Memorandum Opinion and Order, 9 FCC Rcd. 7781 (1994) (rejected justification where 32 channels were placed on an "à la carte" tier, although operator was not sanctioned for the attempted evasion).

[33] To mention only two: the Commission early adopted the practice of allowing cable operators to keep relatively small subscriber overcharges on the grounds that the total overcharge per subscriber was *de minimis*. *See, e.g., In re King Video Cable Company Valley Springs, California*, *Benchmark Filing to Support Cable Programming Service Price*, Memorandum

When a local franchising authority issues a rate order, that order is binding law unless and until it is either stayed or reversed by the Commission.[34] Allowing cable operators routinely to ignore rate orders that have been appealed but not stayed – as they have done throughout the history of rate regulation[35] – is tantamount to allowing evasions on a massive scale. Yet it was five years after 1993 before the Commission made any ruling that addressed cable operators' obligation to comply.[36] And the Commission has never taken any systematic steps to make sure that the industry is in fact complying with the basic principle that decisions of franchising authorities, the FCC's co-regulators, *must be obeyed* until stayed or reversed.

Opinion and Order, 10 FCC Rcd. 1707, ¶ 8 (1995); *In re King Video Cable Company Jackson, California,* Memorandum Opinion and Order, 10 FCC Rcd. 1706, ¶ 8 (1995). Nothing in the statute authorizes the Commission to approve unreasonable rates on such grounds. More disturbingly, after the passage of the 1996 Act, the Commission applied that Act's deregulatory standards *retroactively* to complaints filed *before* the 1996 Act, on the remarkable grounds that it would serve no purpose to adjudicate these complaints because the later deregulation would automatically allow the cable operator to recapture the overcharge through a later rate increase – a rationale inconsistent with the notion that competitive pressures would limit arbitrary CPS tier rate increases. *See, e.g., In re Prestige Cable TV, Order Dismissing Rate Complaints*, Order, 12 FCC Rcd. 21,103, ¶ 4 (1997).

[34] *See, e.g.*, 47 C.F.R. §§ 76.922, 76.923, and 76.937(a); *In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, MM Docket No. 92-266, Thirteenth Order on Reconsideration, 11 FCC Rcd 388, ¶ 24 (1995) ("*Thirteenth Reconsideration Order*") ("a cable operator. . . may not increase its BST rates without approval from the franchising authority"); "An operator's appeal of an LFA's rate order does not stay that order. . . The Commission's rules are unequivocal: 'Operators may implement rate changes proposed in their filing 90 days after they file *unless the franchising authority rejects the proposed rate.*'" *In re TCI of Richardson, Inc., Appeals of Local Rate Orders Issued by the City of Richardson, Texas*, Memorandum Opinion and Order, 12 FCC Rcd. 21,690, ¶¶ 41-42 (1998) ("*Richardson Order*"), *quoting Thirteenth Reconsideration Order* at ¶ 9 (emphasis added), *modified in other respects*, *In re TCI of Richardson, Inc., Petition for Reconsideration of Bureau Order Resolving Local Rate Appeals*, Memorandum Opinion and Order on Reconsideration, 14 FCC Rcd. 11,700, ¶ 33 (1999) ("*Richardson Reconsideration Order*").

[35] *E.g., In re Falcon Cablevision*, 12 FCC Rcd. 8229 (1997); *In re TCI Cablevision of Oregon, Inc.*, 12 FCC Rcd. 8216 (1997).

[36] *Richardson Order* at ¶¶ 40-42.

The second point is related. The Commission made a number of rules requiring operators to produce information, adhere to deadlines, and the like. But it failed to include rules that would provide simple, nationwide *enforcement* tools localities could use to make sure those rules were obeyed. When there is no penalty or other sanction for failure to comply, there is no obvious incentive for compliance. And there is no guarantee that local communities have the tools for such enforcement already in place. The Commission appears to have assumed that communities already had the power to impose fines or forfeitures for violations of the Commission's rules and the communities' rulings.[37] But that is not generally the case. In 1993 most franchise agreements of course predated the new rate rules, and few included specific enforcement mechanisms. Nor did the Commission itself ever take serious steps to enforce its own rules by sanctions that would provide a serious incentive for compliance.[38]

B. Recommendations

The following steps are suggested as ways to help address the problems mentioned above.

[37] *See, e.g., Third Reconsideration Order* at ¶¶ 1, 80.

[38] For example, in one decision during the period of CPS tier regulation, where an operator failed outright to file the forms necessary for an increase under the Commission's rules, FCC merely extended the refund liability until the operator implemented the new rate order. *In re TCI Cablevision of Georgia, Complaint Regarding Cable Programming Services Tier Rate Increases*, Order, 12 FCC Rcd. 23,198, ¶ 8 (1997). Under such circumstances, an operator had nothing to lose by trying to evade the rules; at worst, it would merely have to make the refunds it would otherwise have had to make, and there was always the possibility it might get away with the evasion unnoticed.

1. Clearly Affirm Operators' Obligation to Comply With Local Rate Orders

The Commission should clearly restate and reaffirm the principle that a cable operator must comply with local rate orders unless and until those orders are stayed or reversed by the Commission. The operator must reduce its rates as ordered; make refunds as required; and use the approved rates as its starting point for future rate filings, whether or not the operator has appealed the order.

There is no need to make new law here. This legal fact is evident and inherent in the rate regulation authority enacted in the Cable Act itself. But experience indicates that the cable industry needs to be told without any ambiguity or confusion that it is legally required to comply with such orders.

2. Establish Enforcement Mechanisms

First and foremost, the Commission should enforce its own rules, rather than bending them to overlook cable operators' evasions. But in addition, the Commission should establish straightforward fines or forfeitures that localities can use to enforce the Commission's rate rules, address operators' refusal to produce required information, and deal with refusals to comply with local rate orders. In particular, where operators fail to respond to information requests or comply with rate orders, additional fines should be imposed for each day's delay. These measures could be separately established by regulation, or by delegation of Commission authority under 47 C.F.R. § 1.80. Such a nationwide method would immeasurably simplify the fundamental matter of making the existing rules work. It would also satisfy the cable industry's oft-stated preference for uniform national approaches. The amounts involved should be sufficient to give cable operators a substantial incentive to comply. (This means that at a minimum, they must outweigh the benefits operators would realize from refusing to comply.)[39]

Such enforcement rules could appropriately be utilized by local franchising authorities, the Commission's co-regulators. Any such sanctions could be made appealable to the Commission, so that the Commission could correct any mistakes in application at once. Under the same principle of compliance with local orders referred to above, however, fines or forfeitures should be paid by operators at once, without waiting for an appeal to be resolved – to be returned if the sanction is ultimately reversed.

3. Make Available Actual Competitive Rates As Alternative Measures of Reasonable Rates

One of the most disturbing anomalies in rate-setting occurs when there is actual competition from a second cable operator in part, but not all, of an incumbent operator's service area. The result is frequently that in the competitive area rates go down, and special promotional offers reduce effective rates even further. Meanwhile, rates in the nearby *non*-competitive area remain significantly higher, and the same promotional terms are not made available.[40]

To be sure, this sort of contrast vividly illustrates the benefits of real competition. But it also demonstrates the burden of unreasonable (supracompetitive) rates placed on the subscribers not fortunate enough to live in the competitive area. If residents in one block, where two operators compete, pay (for example) $8.00 for service, while in the next block, beyond the

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[39] While some cable operators may comply voluntarily with local orders and requests, experience indicates there are enough "bad actors" to make sanctions necessary.

[40] For example, in Lebanon, Ohio, a municipal system began operating three years ago. Time Warner increased content and lowered prices. It refused specific requests from neighboring communities, lacking the municipal competitor, to extend the same changes to those

overbuilder's range, residents pay $10.00 for the same service, there is perhaps the clearest evidence possible that the less-favored residents are overpaying by $2.00 due to the incumbent's market power.[41]

The Commission should adjust its rules to allow this evidence to be used in setting rates. The entire complex edifice of the benchmark scheme is, of course, merely an attempt to replicate what a competitive rate *would* be in the absence of actual competition. Referring to a nearby area in which there *is* actual competition is a much faster and more direct way to arrive at the same result. Thus, the use of actual competitive rates as a standard for nearby non-competitive rates would carry out the purpose of the benchmark method while streamlining the mechanism.[42] The resulting savings in "overhead" costs would benefit franchising authorities, cable operators, and the Commission (in its appeal capacity) as well.

Implementing this approach would involve rule changes of the following sorts:

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communities. Similar situations have occurred within a single jurisdiction where an overbuilder has not yet extended its system throughout the jurisdiction.

[41] It should be kept in mind that two competing sources do not necessarily make for robust or vibrant competition. It is easy, for example, to have two competitors fall into a price maker-price taker relationship, in which rates still do not descend to fully competitive levels. *See* F. Scherer, *Industrial Market Structure and Economic Performance*, 56 (2d 1980); Stigler, *Notes on the Theory of Duopoly*, 48 Pol. Econ. 521 (1940). But the nearby overbuild at least establishes that the true competitive rate can be no *more* than (in the hypothetical example) $8.00.

Rate disparities of this sort are sometimes referred to as acceptable on the grounds that adjusting rates to "meet competition" is a good thing. Certainly it is a good thing when alternative providers give up monopoly profits to compete as to price in the competitive area. What is not a good thing is that the incumbent monopolist can continue to charge a supracompetitive price outside the competitive area. (Indeed, the overcharges in the monopoly area may allow the larger incumbent to cross-subsidize unreasonably low – predatory – prices in the competitive area, in order to drive the competitor out of business.) The point here is: When the incumbent reduces rates to "meet competition," that necessarily establishes that the competitive rate can be no higher than this "meeting competition" rate.

[42] *See NPRM&O* at ¶¶ 7, 27-29, 42-43 ("recalibration of the 'competitive differential'").

(1) If a cable operator charges a given per-channel rate in one area where it faces actual competition from a second wireline multichannel video provider, there is a rebuttable presumption that a franchising authority can set the same per-channel rate in another area where the operator does *not* face such actual competition. The operator can overcome this presumption by making a quantifiable and verifiable showing of cost differences between the two areas, using those cost differences to adjust the rate. The burden should be on the operator to show that such an adjustment is necessary and that its amount is fully supported by verifiable costs.[43]

(2) To enable a franchising authority to determine what the relevant rates are, a cable operator should be required to produce within ten days of a request its rate card and channel lineup for any jurisdiction, or area within a jurisdiction, specified by the local franchising authority.

(3) To make this work effectively, the Commission would need to apply effective competition tests according to those areas where competition actually does and does not exist, rather than by entire franchise areas. For example, it might be necessary to compare two sections of the same franchise area if the area is only partially overbuilt – for example, if a second cable operator's build-out is not yet complete, or if a local community has authorized a partial overbuild as the only

[43] To prevent any potential collusion between the operators, the franchising authority should retain the option of using the Commission's traditional methodology instead, if that methodology actually yields a lower rate. There is ample precedent for such alternatives: for example, the option for a cable operator to use benchmark or cost-of-service methods.

practical way to achieve even limited competition. There are independent reasons to make this change in the Commission's rules in any case.[44]

Using actual competitive rates as an indicator of competitive prices would have the virtues of simplicity as well as fairness in carrying out the congressional mandate to guard subscribers against supracompetitive rates.

It should be noted that this is not a cure-all for cases where the rate rules fail to deliver truly competitive rates. There may be many areas where such comparisons are not available. The suggested rule, however, does offer both simplicity and substantive improvement.

4. Proactively Investigate Evasions

No doubt the Commission would prefer not to expend resources on pursuing and preventing evasions. Local franchising authorities sympathize with that sentiment. Willing and cooperative compliance would be better for all concerned than an expensive enforcement campaign. Yet the examples above make clear that evasions cannot be prevented (as the statute requires) simply by making rules and hoping that they will be obeyed.

The Commission needs to take affirmative steps to find out whether its rules are working. This could involve spot-checks to review randomly selected filings and confirm supporting data, as in an IRS audit. It might also involve working with franchising authorities to identify areas where evasions may be occurring and taking a closer look at practices that may be used to evade

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[44] *See* Section VI below.

Such an approach need not conflict with the judicial limitations on the Commission's application of the uniform rate rules of 47 U.S.C. § 543(d). *Time Warner Entertainment Co. v. FCC*, 56 F.3d 151, 190-92 (D.C. Cir. 1995). The Commission would not be requiring uniform rates across an "effective competition" region. Rather, it would be using the *unregulated* rates in the competitive area to set regulated rates in the competitive area. Rates in the area of real competition would remain unregulated.

the effect of the Commission's rules. For example, local communities could report to the Commission where fines or forfeitures are being applied, and thus highlight violations of the Commission's rules. While such proactive steps may involve costs, the Commission was expressly provided with funding at the outset of rate regulation to cover its administrative expenses, including the expenses of rate regulation.[45] That funding should be employed to further the purposes of the statute – to benefit consumers (who, after all, are the ones who pay the regulatory fee under the Commission's pass-through rules where rate regulation is effective). This is one way in which the Commission can do so.

Most of all, where the Commission finds (as in the à la carte tier affair) that cable operators are taking actions or adopting positions for no apparent reason *except* to evade, the Commission must impose sanctions on those operators for abuse of the Commission's process. These sanctions must be *over and above* the rollback to a reasonable rate – which is no punishment at all, merely the restoration of an approximately competitive price and denial of the benefits of monopoly power. We are unaware of any instance in the ten-year history of rate regulation in which the Commission applied any sort of sanction to a cable operator, no matter how uncooperative the attitude or how flagrant the violation of Commission regulations. Unless this changes, operators will have no real incentive to comply.

5. Proactively Investigate Anticompetitive Practices

Regardless of what repairs can be made to the rate regulation process, real competition is still better than the simulated competitive pricing of rate regulation. Accordingly, the

[45] 47 U.S.C. § 159(a); 47 C.F.R. § 1.1155; *In re Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, Fourth Order on Reconsideration, 9 FCC Rcd. 5795, ¶¶ 9, 12, nn.28, 35 (1994) ("*Fourth Reconsideration Order*").

Commission should investigate certain obstacles to wireline competition, in the interest of making rate regulation obsolete. In this respect, the history of the last several years is significant. Overbuilders have reported a variety of tactics used by incumbents to fend off competition.[46] The Commission should launch a serious investigation of actions taken by incumbents to frustrate, delay, or halt competition – predatory pricing, disinformation campaigns, threats of litigation, attempts to buy out competitors, and the like.[47] The Commission

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[46] For example: In one community with a municipal overbuilder, the incumbent cable operator offered 200 channels, including sixteen premium channels, for $24.95 month, plus $200 to switch to the incumbent's cable service, an additional $200 to switch to the incumbent's Internet service, and forgiveness of any old debt owed to the incumbent or its predecessor. *See* Comments of Scottsboro (Alabama) Electric Power Board ("SEPB") in the *Notice of* Inquiry in CS Docket No. 01-129, at 5, Appendix B (Aug. 3, 2001) (*"SEPB Comments")*. In a surrounding community with no competition, the incumbent offered 150 channels for $77.90 – *i.e.*, 212% more than Scottsboro rates for 25% fewer channels. SEPB used the incumbent's SEC filings to estimate that the Scottsboro month rate was $0.87 less than the incumbent's national average monthly operating expense (which did not include the additional cost of the $200 bounties, amnesty program, and six door-to-door promotional campaigns). *Id* at 6. Notably, the incumbent's rate in Scottsboro is $6.71 less than the average national monthly rate (programming only) offered by competitive systems for 61 channels – *i.e.*, almost 25% more than the average competitive monthly rate for 228% more channels. *See 2001 Competition Report* at 10, Table 4. Other competitive providers have also reported incumbents offering below national average rates above average channel packages, switching bounties of $200-$300, and old debt forgiveness. *In re Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, CS Docket No. 01-129, Comments of Knology, Inc. to the Notice of Inquiry, 4-5 (filed late, Nov. 20, 2001). *In re Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors to AT&T Comcast Corporation, Transferee,* MB Docket No. 02-70, RCN Telecom Services, Inc., Written *Ex Parte* Comments in Response to Comcast (filed Aug. 27, 2002); *In re Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors to AT&T Comcast Corporation, Transferee*, MB Docket No. 02-70, RCN Telecom Services, Inc., Written *Ex Parte* and Accompanying Declaration (filed Aug. 14, 2002).

[47] *See, e.g.*, Gaskins, *Dynamic Limit Pricing: Optimal Pricing Under Threat of Entry*, 3 J. Econ. Theory 306 (1971) (a dominant firm may set a price lower than the point at which marginal costs equals price to discourage entry of other providers, which may ultimately allow the dominant firm to sell at a higher price in the future).

should also look closely at incumbents' demands for "level playing field" terms in state laws that may afford incumbents pretexts to confuse, delay, and impede competition.[48]

6. Provide Funding for Implementation

One way in which cable operators can evade the effects of rate regulation is to make the process so expensive that many local communities will be "priced out" of the regulatory market. For example, frivolous appeals based on patently frivolous theories – such as the view that an operator can continue to charge subscribers for a channel they do not receive – have no purpose but to intimidate and deter local franchising authorities from applying the Commission's rules as Congress intended.[49]

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[48] The Commission has shown great openness to allegations by the telecommunications industries that franchising authorities are impeding competition. *See, e.g.*, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of* 1996, CC Docket No. 98-146, Third Report, 17 FCC Rcd. 2844 (2002); *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of* 1996, CC Docket No. 98-146, Notice of Inquiry, 15 FCC Rcd. 16,641 (2000); *In re Promotion of Competitive Networks in Local Telecommunications Markets*, Notice of Proposed Rulemaking and Notice of Inquiry in WT Docket No. 99-217 and Third Further Notice of Proposed Rulemaking in CC Docket No. 96-98, 14 FCC Rcd. 12673, ¶¶ 70-85 (1999). There seems to be no evidence that the Commission is equally open to the idea that the incumbents themselves – *who, unlike the communities, have every reason to oppose competition* – may be acting anticompetitively. If the Commission has the resources to intrude, in the interests of competition, in areas where by statute it has no jurisdiction – *see, e.g.,* Brief Amicus Curiae of the Federal Communications Commission, *TCG v.City of White Plains*, 305 F. 3d 67 (2d Cir. 2002) – then the Commission must certainly have resources to pursue potential anticompetitive practices in an area where it has a direct mandate from Congress to prevent evasions.

[49] *See* Section IV below.

The Commission could ameliorate this problem by making it explicit that local communities can charge cable operators, over and above their franchise fees, for the cost of rate regulation.[50]

When foot-dragging and refusal to cooperate (for example, on information requests) turn the rate review process into a war of attrition, it is the deep pockets who benefit. In this case – particularly in light of the degree of consolidation in the industry over the past ten years – those deep pockets belong to the regulated entities. Alternative means of funding that do not further burden already-strained local resources (which must cover everything from schools to police and fire protection) could help to equalize this David-and-Goliath situation.

The above suggestions deal with some of the broad problems facing rate regulation in general. The following sections, by contrast, seek to focus on certain selected specific problems. In each case an identification of the problem is followed by suggestions as to how it might be solved.

III. THE COMMISSION'S RULES PRETEND THERE IS "EFFECTIVE COMPETITION" WHERE THERE IS NO REAL RATE RESTRAINT

A. Problem

The *NPRM&O* raises the question of how cable operators may best demonstrate the presence of effective competition – conditions that make rate regulation unnecessary because the

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[50] The Commission itself found that it needed new funding to pay for the costs of implementing Congress' directive to regulate rates. *See Fourth Reconsideration Order* at ¶ 9 ("The purpose of requiring cable systems to pay various regulatory fees to the Commission is to permit the Commission to recover the annual cost of its various regulatory activities."). Local governments are in no better position to assume additional financial burdens.

market itself provides the necessary discipline to keep rates reasonable.[51] This issue does in fact mark a problem that has long dogged the Commission's current rules. Those rules create several types of loopholes through which an operator may make an apparent showing of effective competition, even though market forces are not really acting to keep rates reasonable.

1. Divided Franchise Areas

The most striking example is the case of a divided franchise area in which cable operators that were granted overlapping franchises have instead effectively divided the community between them. Each operator may hold a franchise for an entire city, for instance, yet each keeps religiously to its own territory and does not overbuild its colleague.[52] No subscriber actually has a choice, and neither operator has an incentive to keep rates low so as to attract subscribers from a competitor. Yet in such cases the Commission has frequently declared effective competition, based on the notion that the operators *could* overbuild each other, if they ever chose to do so.

The Commission has recognized from time to time that supposedly overlapping operators may in fact be bound to engage in no competition at all.[53] But the Commission has generally

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[51] *NPRM&O* at ¶¶ 52-53.

[52] *See, e.g.*, *In re Century Cable of Northern California, Inc.*, *Petition for Revocation of the Certification of the City of San Buenaventura, California to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 14 FCC Rcd. 18,604 (1999), *aff'd on reconsideration*, *In re Century Cable of Northern California, Inc.*, Memorandum Opinion and Order, 14 FCC Rcd. 18,604 (1999). This reluctance to compete is an attitude of very long standing in the cable community. *See, e.g.*, *Paul Allen Becomes Overbuilding with $1.65 Billion in RCN*, Communications Daily, Oct. 5, 1999, at 4; Matt Stump, *Changing Times*, Cable World, Oct. 18, 1999, at 50.

[53] *See, e.g.*, *In re Telesat Cablevision, Inc.*, *Petition for Reconsideration of Orange County, Florida to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 2807, ¶ 7 (1995) (contract of sale including agreement not to provide service in an area shows affirmative decision to limit service area); *In re Cecilton CATV Inc.*, *Petition for Reconsideration of Certification of Cecil County, Maryland to Regulate Basic Cable Service*

required an extraordinarily high standard of proof as to the unlikelihood of such competition, even after years of silent refusal to compete by the cable operators.[54] As a result, subscribers who have no real hope of competition are left unprotected from unreasonable rates, contrary to the statutory mandate. Only rarely has the Commission acknowledged that years of unbroken side-by-side monopoly conditions are likely to continue, barring evidence to the contrary.[55]

2. DBS-Only "Competition"

A second loophole has been opened by the recent wave of industry filings claiming that DBS alone provides sufficient "effective competition" to justify abandoning rate regulation. The

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Rates, Memorandum Opinion and Order, 10 FCC Rcd. 2937, ¶ 11 (1995) (loan agreement incorporating agreement not to overbuild shows affirmative decision to limit service area).

[54] *See, e.g., In re Daniels Cablevision, Inc. D/B/A/ Pala Mesa Cablevision, D/B/A/ North County Cablevision, D/B/A/ Cable TV of Lake San Marcos, Application for Review of Order of the Cable Services Bureau Granting Petition for Revocation of the Certification of San Diego County to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 12 FCC Rcd. 16,594, ¶ 8 (1997); *In re TKR Cable of Northern Kentucky, Petition for Revocation of Certification of Unincorporated Boone County, Kentucky to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 11 FCC Rcd. 9973, ¶ 20 (1996); *In re Valley Center Cable Systems, L.P., Application for Review of Order of the Cable Services Bureau Granting Petition for Reconsideration of San Diego County to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 11,940, ¶ 11 (1995); *In re Apollo Communications Corporation, Petition for Reconsideration of Certification of the County of Bartholomew, Indiana to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 988, ¶¶ 4, 6 (1994); *In re C-TEC Cable Systems of Michigan, Inc., Petition for Reconsideration of Certification of Cascade Charter Township, MI to Regulate Basic Cable Service Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 2178, ¶¶ 4, 6 (1994); *In re TCI Cablevision of Georgia, Petition for Revocation of Certification of the Consolidated Government of Columbus, Georgia to Regulate Basic Cable Rates*, Memorandum Opinion and Order, 10 FCC Rcd. 597, ¶ 5 (1994), *quoting First Reconsideration Order* at ¶¶ 24 and 25; *In re American Cable Company, Petition for Reconsideration of the Certification of City of Columbus, Georgia to Regulate Basic Cable Rates*, Memorandum Opinion and Order, 9 FCC Rcd. 7212, ¶ 6 (1994).

[55] *See, San Buenaventura Order*.

Commission has approved many such filings.[56] Yet the notion that DBS "competition" alone suffices to keep rates reasonable flies in the face of the Commission's own finding that "the presence of effective competition due to DBS overbuild status has no significant effect on cable rates."[57] The fact is that DBS "competition" is not keeping rates down, no matter how much the cable industry may fear it. Thus, to depend on DBS is to abandon the Commission's responsibility under the law to protect subscribers from unreasonable rates.

It does not appear from the Commission's recent approvals that the Commission has made any independent study of this new form of "competition," nor undertaken any independent investigation of the cable operators' allegations, factual data, or methodologies. On the contrary, it appears that the Commission is accepting operators' statements essentially at face value and placing the burden on local franchising authorities to refute these claims. But this approach impermissibly shifts the burden of proof to the local community – the party least able to address the issue.

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[56] *E.g., In re Charter Communications Entertainment I, L.L.C., d/b/a Charter Communications, Petition for Determination of Effective Competition in Sixteen Missouri Communities*, Memorandum Opinion and Order, DA 02-2946 (Nov. 1, 2002); *In re TWI Cable Inc., d/b/a/ Time Warner Cable Petition for Determination of Effective Competition in the City of Live Oak, Florida,* Memorandum Opinion and Order, DA 02-2488 (Oct. 4, 2002); *In re Marcus Cable Associates, d/b/a/ Charter Communications, Inc., Petition for Determination of Effective Competition in Denton, TX (TX0580)*, Memorandum Opinion and Order, DA 02-2174 (Sept. 6, 2002); *In re Falcon Cable Systems Company II, a California Limited Partnership, d/b/a Charter Communications Petitions for Determination of Effective Competition in Twelve Oregon Cities*, Memorandum Opinion and Order, 17 FCC Rcd. 4648 (March 15, 2002); *In re Marcus Cable Associates, D/B/A/ Charter Communications, Petitions for Determination of Effective Competition in: Burleson, Texas; Keller, Texas; Mansfield, Texas; Edgecliff Village, Texas; Kennedale, Texas; Blue Mound; and North Richland Hills,* Memorandum Opinion and Order, 16 FCC Rcd. 14,435, ¶ 3 (2001); *In re Time Warner Entertainment – Advance/Newhouse Partnership D/B/A/ Time Warner Communications,* 15 FCC Rcd. 8852 (2000); *Jones Intercable, Inc.*, 15 FCC Rcd. 7257 (2000).

[57] *2002 Competition Report* at ¶ 45. *See* n.19 *supra* and accompanying text.

It is difficult for local communities to investigate the weaknesses in the industry's DBS filings, because they do not have access to the underlying data. Even if the franchising authorities subjected to "effective competition" filings were not constrained by the limited time – twenty days – available under the Commission's pleading schedules;[58] even if the cost of a detailed factual investigation were not prohibitive; the fact remains that the SkyTrends data on which cable operators rely are not available to local communities – only to cable operators. And when the operator can pick and choose which data to present, it is unlikely that franchising authorities with limited time and limited means will be able to locate any weaknesses, biases, or outright inaccuracies that may exist in the operators' carefully chosen data set.

For example, a September 3, 2002, filing by Charter for a number of small cities including Town and Country, Creve Coeur, and Ballwin, Missouri, used government census data for the number of municipal households, but used SkyTrends data for the number of households per Zip code – a number that is also available from the census data. It is difficult to determine the impact of such inconsistencies. But there appear to be other, grosser errors. The city of Creve Coeur includes homes in two Zip codes, 63141 and 63146, but the filing appears to omit 63146 altogether. Town and Country includes three Zip codes, 63131, 63017, and 63011, two of which contain Charter corporate offices – but only 63017 appears to have been used in the filing. The data also reports one DBS subscriber and 498 households in Zip code 63022, but that Zip code turns out to contain only post office boxes: the census data shows no houses there.[59]

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[58] *See* 47 C.F.R. § 76.7(d).

[59] The post office for that Zip code may be contacted at 636-227-5783.

Clearly the reliability of the data presented in such a petition is open to question, and it should be the responsibility of the cable operator to show its accuracy.[60]

Even if a serious investigation by the Commission were to determine that the industry's estimates of DBS *penetration* were correct, there may well be other reasons why DBS fails to provide an effective competitive alternative. (Again, we know that it does fail, because the Commission and the GAO found "no significant effect" on rates from DBS "competition.") The Commission appears to have assumed in its original rules that DBS would provide programming "comparable" to cable based solely on offering more than twelve channels of service.[61] Yet the programming packages offered by DBS are not qualitatively identical to cable's basic tier, whose defining factor is the inclusion of broadcast and PEG channels. Until recently, DBS could not provide local broadcast channels; and even now, only certain areas nationwide receive some or all of the local channels available on the local cable system.[62] DBS subscribers do not receive

[60] At the most basic level, there is no reason to think that the SkyTrends data must be wholly accurate, particularly when both the DBS systems providing the data (for the benefit of the financial markets) and the cable operators presenting the data (for purposes of their effective competition claims) have an interest in overstating subscribership. Such overstatements are not unheard of in other contexts. *See, e.g.*, Robert Frank and Deborah Soloman, *Adelphia Inflated Customer Base – Numbers Overstated By Up to 10%*, Wall Street Journal, June 7, 2002, at A3. Unless and until the Commission conducts an independent investigation, there is no way to know.

[61] *See, e.g.*, Rate Order at ¶¶ 32, 38 & n.100. Under 47 U.S.C. § 543(*l*)(1)(B)(i), a potential competitor must offer "comparable video programming." The statute does not define "comparable." Commission rules at 47 C.F.R. § 76.905(g) define "comparable" for this purpose as involving at least twelve channels of video programming, "including at least one channel of nonbroadcast service programming."

[62] Satellite Home Viewer Improvement Act of 1999, included as Title I of Appendix I of the Cosolidated Appropriation Act of 2000, Pub. L. N o. 106-113, 113 Stat. 1501, 1501A-523 to 1501A-544 (1999).

The Commission had determined on an interim basis that local broadcast signals must be included if programming is to be "comparable" at least with respect to the fourth statutory local public, educational, or governmental access channels.[63] One plausible reason why DBS has not acted as a brake on cable rates is that viewers do not see the two as truly interchangeable products.[64]

3. Anticipation of Future Competition

A third abuse of the "effective competition" notion occurs when a cable operator relies on the potential for *future* competition as a way of escaping rate regulation *now*. It has been suggested that the mere threat of possible competition may suffice to keep cable rates in line.[65] It

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criterion for effective competition. Later, however, the Commission reversed itself and determined in its final rule that comparable programming under all of the effective competition criterion should be defined as twelve channels including one channel of nonbroadcast service. *In re Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, Order and Notice of Proposed Rulemaking, 11 FCC Rcd. 5937, ¶ 12 (1996) and *In re Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, Report and Order, 14 FCC Rcd. 5296, ¶¶ 16-22 & nn.57-58 (1999) ("*Effective Competition Order*").

[63] The Commission seems to have dismissed this difference as insignificant. *In re Cox Com, Inc. [New Orleans]*, Memorandum Opinion and Order, 14 FCC Rcd. 7134, ¶ 19 (1999). Yet numerous local communities have considered such channels sufficiently important to count among their future cable-related needs and interests, and have devoted significant sums to their development.

[64] Moreover, beyond the programming packages involved, the different characteristics of DBS and cable may give consumers pause in substituting one for the other. DBS involves the physical attachment of unfamiliar and bulky equipment (compared to a cable set-top box), in part on the outside of a residence. The equipment may or may not require significant up-front capital investment from the consumer, depending on the particular promotional packages involved. That investment may be particularly difficult for those on low or fixed incomes, many of whom are tenants likely to move more frequently than homeowners. The subscriber (particularly in MDUs, urban high-rise areas, heavily forested or wooded areas, and/or northern latitudes further from equator-orbiting DBS satellites) may lack line-of-sight to the satellite. The feed is normally limited to a single channel for all televisions in the house, unless additional receivers, specialized antennae, and additional service fees for additional receivers are purchased. Any or all of these points – which have been loudly publicized by the cable industry as reasons for choosing cable over satellite – may help to explain why subscribers do not necessarily see DBS as a ready substitute for cable.

[65] The Commission cited: "*Time Warner Entertainment-Advance/Newhouse Partnership and Paragon Communications* (North and South Pinellas Counties, FL), 12 FCC Rcd 3143 (Cab.

is at least equally likely, however, that the threat of possible competition may spark a wave of rate *increases*, as the incumbent operator seeks to extract all possible monopoly rents while it still can and to build up a cushion or "war chest" for its battle against competition.

In some cases, the Commission has shown a disturbing willingness to ignore present economic facts in favor of a rosy vision of coming competition. For example, in the City of Boston in 2001, the Commission relied on build-out schedule commitments by overbuilder RCN to support a conclusion that there would be soon be competition everywhere in the City, concluding in effect that the Commission might as well deregulate now.[66] This reliance on a four-year-old build-out schedule, however, ignored the facts of the more recent downturn in the telecommunications industry,[67] the specific financial difficulties faced by RCN,[68] the company's

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Serv. Bur. 1997) (effective competition found where LEC competitor completed 15% of service area and its franchise require completion throughout franchise area within three years; incumbent cable operator has lost subscribers and planned programming upgrades); *Comcast Cablevision of the South*, 13 FCC Rcd 1676 (Cab. Serv. Bur. 1997) (effective competition found where franchises authorize LEC service through franchise areas, LEC competitors began by using facilities constructed for video dialtone service through parts of the franchise areas, and incumbent cable operator has responded competitively in anticipation of the LEC competition.)." *See Effective Competition Order* at n.45.

[66] "In order to establish the presence of effective competition, a cable operator need not prove that a competing LEC is providing service throughout its service area. Instead, if the LEC is franchised, a showing regarding the coverage and construction obligations in the franchise agreement normally is sufficient. . . . To the contrary, RCN's testimony supports the Bureau's conclusion that RCN *intends* to build out its system to serve the entire city of Boston, albeit at a slower pace than it originally intended." *In re Cablevision of Boston, Inc., Petition for Determination of Effective Competition, Application for Review*, Memorandum Opinion and Order, 17 FCC Rcd. 4772, ¶¶ 9, 14 (2002) ("*Boston Review Order*") (emphasis added).

[67] *See, e.g.*, Mavis Scanlon, *RCN: After the Fall*, Cable World, Jan. 1, 2001 at 4 ("The pullback in the capital markets 'definitely is going to affect every overbuilder'"); Lee Bergquist, *New Cable Company Pulling Plug; Digital Access Cites Inability to Raise Capital*, Milwaukee Journal Sentinel, Mar. 3, 2001, at 1D ("when financing is drying up for many companies that want to build cable systems in markets where there is existing cable operator.").

[68] *See, e.g.*, Andrea Estes, *For Cable Rival, No Room at the Poles: Current Utility Providers Reluctant to Add RCN*, The Boston Globe, Dec. 17, 2000, at 1 (South Weekly Ed.)

slowdown in construction in Boston in particular,[69] and explicit statements by RCN that it would not be able to meet its build-out schedule in Boston.[70] As a result, the Commission declared victory and decreed effective competition, even though the majority of the City's subscribers had no choice of cable operator.

The postscript to the Commission's decision in the Boston matter is particularly galling. Thirty-five days after the Commission's decision, RCN requested to be certified as an OVS operator for the City of Boston.[71] Four days later, RCN notified the City that no money for new construction in Boston would be budgeted in 2002 or 2003, and further requested "relief from its franchise obligations." In the interest of promoting competition and competitive choice for the City's residents, in October 2002, the City of Boston reluctantly agreed to terminate RCN's franchise and grant RCN an OVS license. The OVS license does not contain build-out requirements, although it does require that if and when RCN is able to budget money to begin

("But now – two years after RCN signed deals with Quincy, Weymouth, and Randolph – RCN officials last week said they aren't even close to being ready to go."); Tom Kirchofer, *Media Upstart Fires 65*, The Boston Herald, Jan. 23, 2001, at 25 ("RCN spokeswoman Nancy Bavec said "…we're going to be expanding in the Boston market at a lesser rate of growth then previously"); Len Boselovic, *AT&T Woes Hurt C-COR Stock's Reception*, Knight-Ridder Tribune Business News, Jan. 8, 2001, at B-7 ("RCN Corp. (RCNC) announced last month it would spend only about $775 million next year, 50 percent lower than its original budget"); Bruce Mohl, *Cable TV Mergers Delaying Rate Hikes, Big Firms Have Yet To Announce Plans for Coming Year*, Boston Globe, Dec. 26, 2000, at C1 ("RCN, which is building a network from the ground up in Greater Boston, has been experiencing financial difficulties lately").

[69] *In re Cablevision of Boston, Inc., Petition for Determination of Effective Competition*, Application for Review of Determination of Effective Competition *in re* Cablevision of Boston, Inc., Exhibit 2 [RCN Construction Schedule (March 13, 2001)] (filed Aug. 20, 2001) ("*Boston Application for Review*").

[70] *Boston Application for Review* at 3-4, Exhibit 1 [Thomas Steel, Vice-President and Regulatory Counsel for RCN, Testimony at Annual Performance Review of RCN BECO LLC (March 14, 2001)] at 7, 8, 10.

[71] Open Video System Certification Application of RCN BecoCom, LLC (filed April 18, 2002), *available at* http://www.fcc.gov/mb/ovs/rcnbos.doc (last visited 11/4/02).

new construction in Massachusetts, 50% of those dollars will be spent in Boston. Thus, the build-out requirement on which the Commission premised its premature declaration of effective competition no longer exists.

However, since the Commission's effective competition decision, AT&T has attempted to avoid truing-up its 2000 rates, arguing that the 2001 effective competition determination, based on the now-void 1999 RCN franchise agreement, stripped the City of authority to regulate rates or order refunds as of the date of Cablevision's original 1997 Petition for Determination of Effective Competition.[72] In addition, after agreeing not to raise rates as a condition of the City's approval of the AT&T-Comcast merger and franchise transfer, AT&T-Comcast attempted to impose a $3.00 hike in the form of an equipment rate increase.[73]

It is understandable to look forward to the replacement of rate regulation rules by robust competitive forces. But a promise of competition is not the same as actual competition. Wishful thinking cannot be allowed to drive the Commission's response to its congressional mandate. That was the problem with the 1984 Act's premature elimination of rate regulation; it was why the 1992 Act's restoration was necessary; and it requires the Commission to act now on facts, not merely hopes.

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[72] Letter from James White, Jr, Senior Attorney, AT&T Broadband, to Alicia Matthews, Director, Massachusetts Department of Telecommunications & Energy Cable Television Division, 3-4, (Sept. 14, 2001) ("*Any* order adopted after the Bureau's effective competition decision that prescribes rates or refund payments, *even for a time before July 20, 2001*, would constitute rate regulation that is now precluded in the City (emphasis in original), *citing In re Time Warner Cable*, Refund Plan, 13 FCC Rcd. 17679 at ¶ 2 (1998) ("conditioning enforcement of a rate refund plan on the FCC's denial of a cable operator's petition for effective competition").

[73] Karen E. Crummy, *City Fumes at Cable TV Rate Hike*, Boston Herald, Aug. 16, 2002.

B. Recommendations

The Commission should revise its rules to ensure that they yield a determination of effective competition only where two providers actually offer service to the same subscriber. The operator who wishes to be freed from rate regulation must show that all subscribers in the area to be declared competitive actually have competitive alternatives. Any subscribers who do not have these alternatives should have the right to continue to invoke rate regulation on their behalf, if the local community is willing to continue it. The cable operator must show that the programming offered is in fact comparable in content to the basic cable tier, and that any data used in this showing have been verified by the cable operator. The burden must remain on the cable operator to show these facts, in accordance with the congressional findings underlying the statute.[74]

The Commission should rescind the rule that considers DBS to constitute a competitive alternative everywhere, and decline to find effective competition based solely on DBS. The Commission's own findings, along with those of the GAO, make clear that the existence of DBS does not in fact restrain cable rates and hence make rate regulation unnecessary. Until it can be shown that DBS competition has the same power to produce reasonable rates as wireline competition, the Commission cannot treat DBS as a competitive alternative for purposes of rate regulation.

To provide a reasonable chance to "vet" questionable data that may be submitted, the Commission should consider requiring cable operators to submit an effective competition petition to the local franchising authority *first*, so that the alleged facts can be examined by those

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[74] The cable operator should also be required to avoid including large quantities of unnecessary data – for example, printouts showing data for every city in the state, rather than just

familiar with local conditions, and having the local franchising authority then submit the petition, with its comments, to the FCC. This would parallel the approach the Commission used earlier for CPS tier rate complaints, so that the Commission need not "begin its proceeding with less than a complete record."[75] It would also conform to the original procedure the Commission envisioned for effective competition claims, under which the operator would go to the local community first and approach the FCC only if the local community did not agree to the petition.[76] In this way the Commission could stand a reasonable chance of getting a more complete record and hence making an accurate finding regarding effective competition.

IV. THE COMMISSION HAS ALLOWED OPERATORS TO USE CHANNEL MOVEMENT TO CHARGE SUBSCRIBERS FOR CHANNELS THEY DO NOT RECEIVE.

A. Problem

A problem has developed in the last several years with respect to the apparently simple matter of moving channels out of the basic tier.[77] In at least some cases, cable operators have sought to take advantage of the Commission's rules to continue charging subscribers for channels they do not receive. The result is a telling case study of the cable industry's willingness to distort the Commission's rules to evade the Commission's prescribed methodology for rate regulation.

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those for which the filing is made – to minimize paperwork and improve the ability of the Commission and the local franchising authority to identify the pertinent facts.

[75] *Effective Competition Order* at ¶ 41.

[76] *See* former 47 C.F.R. § 76.915 (prior to 1999); Effective Competition at ¶ 30.

[77] *See NPRM&O* at ¶¶ 12-23, 55.

The Commission's original benchmark rules set a per-channel rate for the basic tier that was deemed to recover all the costs associated with providing a channel to subscribers – both channel-specific costs, such as payments to programmers, and an allocated share of the cost of building and running the cable system as a whole.[78] When a cable operator *removed* a channel from the basic tier, it was thus necessary to back out of the basic tier rate all the costs associated with that channel. Those identifiable costs that were specific to the channel, such as programming costs, could be removed directly. This left the channel's share of the overall network costs, referred to as the "residual," which also had to be removed from the basic tier rate. If this were not done, the basic subscriber would end up continuing to pay part of the cost of a channel no longer carried on the basic tier.[79]

This basic principle was followed for a number of years without significant comment, though in at least one case the Commission did have reason to indicate that its rules required moving the residual, as well as the external costs, when a channel was moved among tiers.[80] The specific mechanism for this removal of the residual had to be changed, however, due to the Commission's adoption of programming incentives that increased the costs the operator could

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[78] *See, e.g., In re Falcon Cable Systems Company, Appeal from a Local Rate Order of the County of San Luis Obispo, California*, Memorandum Opinion and Order, 14 FCC Rcd. 2105, ¶ 7 (1999) ("[T]he benchmark system presumes that the rate charged allows recovery of capital costs"; *In re TCI of Southwest Mississippi, Appeal of Local Rate Order of the City of Ocean Springs, Mississippi*, Memorandum Opinion and Order, 10 FCC Rcd. 8728, n.30 (1995) ("The benchmark rates . . . internalize any other system variances that existed at the time of the survey, such as the carriage of revenue-producing channels").

[79] *See Second Reconsideration Order* at ¶¶ 174-175 (1994).

[80] *See TCI Cablevision of Dallas, Inc., Request for Stay of Local Rate Order of the City of Farmers Branch, Texas*, Memorandum Opinion and Order, DA 99-1159, 14 FCC Rcd 9252 at ¶¶ 3-4, 7, n.3 (1999) ("*Farmers Branch Order*") (granting stay based in part on a conclusion that moving the residual with the channel complied with "the methodology provided in the form and that we have accepted in CPST cases before the Commission").

charge for added channels. When the Commission added these cable operator bonuses in its *Sixth Reconsideration Order* in 1994, it specified that they were to be temporary options, ending on December 31, 1997.[81] However, the Commission wrote the sunset provision for these programming incentives in such a way that an incautious reader might suppose that the *entire* rule for moving the residual (§ 76.922(g)) would sunset on that date.[82]

The only rational way to read this provision is to conclude that the intent of the Commission was to sunset only the new provisions, not all of § 76.922(g). It appears that the previously existing rule (including the residual rule) was then to return and replace the newly-amended rule. The two new methods added in the *Sixth Reconsideration Order* did not take the place of the entire subsection (g). There is no indication in that order that the expiration of these temporary subparagraphs was intended to take the rest of subsection (g) with them. (Indeed, if it did so, there would be *no* way under the Commission's rules to adjust rates when channels are moved or deleted.) Yet, the language of § 76.922(g)(8) anomalously appeared to refer to all of § 76.922(g), rather than solely the new provisions, § 76.922(g)(3) and (g)(7).

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[81] *In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, MM Docket 92-266, Sixth Order on Reconsideration, Fifth Report and Order, and Seventh NPRM, 10 FCC Rcd 1226, at ¶ 98 (1994) ("*Sixth Reconsideration Order*").

[82] "*The new rule* for adjusting rates when channels are added, deleted, or substituted on CPSTs will be in place through December 31, 1997, and will be reviewed prior to the end of that period to determine if there is any reason to continue to provide incentives to increase the number of channels on any CPST. *The new rule will expire on that date and will be replaced by our existing rule* unless it is reinstated by the Commission. The special streamlined cost-of-service procedure for headend equipment costs for small systems also will expire on December 31, 1997 unless it is reinstated by the Commission." *Id.* (emphases added).

It is possible that this appearance of over-inclusiveness was merely a typographical error, as suggested in the Commission's *Farmer's Branch* order.[83] Or the Commission's drafters may have intended the language in (g)(8) to mean that when the "new and improved" subsection (g) sunset, subsection (g) would *revert to the former language of that section*, prior to any sunset requirements and without the *Sixth Reconsideration Order's* new adjustments. Certainly any responsible person who understood how the Commission's rules were supposed to work would have recognized that *some* means of removing the residual from the basic tier rate would have to survive. Otherwise, basic subscribers would still be required to pay residual amounts for a channel they no longer received.[84]

Subsequently, however, at least one cable operator – Time Warner – took the position that the Commission's rules allowed them to leave the entire residual amount in the basic tier rate. According to this claim, the Commission's sunset provision removed the residual rule altogether, leaving no rule at all for backing out the residual. Accordingly, Time Warner claimed, it could not be prevented from continuing to charge basic subscribers part of the cost for a channel they no longer received. Under this literalist reading of the Commission's rules, an operator could continue to remove channels from the basic tier one by one, without adjusting its rates accordingly.[85]

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[83] *Farmers Branch Order* at ¶ 4.

[84] The converse is also true. In the absence of (g)(5), a cable operator that *added* a channel to the BST would not be allowed to *raise* its rates to incorporate the increased residual. One assumes, however, that the Commission's rules should not be read to *discourage* a cable operator from adding new programming.

[85] Or, conversely, it could add channels, one by one, and yet be unable to recover the full value of the channel in an adjusted rate.

In 2001, Time Warner took the above position first in its rate filings, then in discussions with a local franchising authority, then in at least one appeal of the franchising authority's rate order to the Commission.[86] In that case, the double recovery Time Warner sought to capture through this technical pretext involved only a single channel. In other cases, however, the effect was more drastic. For example, the Miami Valley Cable Council, in Ohio, found that Time Warner had removed almost a third of the channels from the basic tier – nine out of 29 channels, or 31% less service – yet adjusted the rate only minimally. The principle, however, was the same: Time Warner was charging the basic subscriber for channels the basic subscriber did not receive.[87]

It should be emphasized that this is a position that *could not* have been adopted by Time Warner in good faith. No cable operator could seriously believe that it should be allowed to continue charging subscribers for a channel it had taken away. Yet Time Warner not only insisted on this absurd position before the local franchising authority, but insisted on appealing the community's rate order to the Commission, causing unnecessary costs for the Commission, the local franchising authority, and the company.

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[86] *See In re Time Warner Entertainment-Advance/Newhouse d/b/a Time Warner v. Southwestern Oakland Cable Commission*, Opposition to Appeal of Local Rate Order (filed Oct. 21, 2002); *In re Time Warner Entertainment-Advance/Newhouse d/b/a Time Warner v. Southwestern Oakland Cable Commission*, Reply to Opposition to Motion to Dismiss Appeal of Local Rate Order (filed Aug. 12, 2002); *In re Time Warner Entertainment-Advance/Newhouse d/b/a Time Warner v. Southwestern Oakland Cable Commission*, Motion to Dismiss Appeal of Local Rate Order (filed July 29, 2002); *In re Time Warner Entertainment-Advance/Newhouse d/b/a Time Warner v. Southwestern Oakland Cable Commission*, Opposition to Appeal of Local Rate Order (filed Nov. 1, 2002). The Southwestern Oakland Cable Commission's filings in that proceeding are incorporated by reference in these Comments.

[87] Time Warner could *also* recover the full cost of the former basic channel from its rates for the CPS tier to which it had been moved, leading to a double recovery.

The Commission's response on this issue is a textbook example of the failure to prevent evasions referred to above. In the *NPRM&O* itself, the Commission incorporated a complex single-paragraph ruling – the "Order" part of the *NPRM&O* – which appeared to be designed to address this problem. It seemed clear that this Order rejected the frivolous position Time Warner had taken, although it did not indicate that any sanctions would be applied against operators who had engaged in this abuse of the Commission's rules. Almost two months later, however, the Commission abruptly issued the Amending Order, rewriting the ordering paragraph of the *NPRM&O* (without explanation or clarification as to what the amendment was intended to accomplish). The resulting paragraph was still more complex and more obscure than the original. To the extent that a reader can understand its goal, however, it appears that the goal may be to allow a cable operator to "get away with" an incorrect methodology for channel movement (one which adjusts the residual, but differently from the way the original *NPRM&O* directed) if the operator had used that methodology before the date of the Amending Order.[88]

The only clue as to why the Commission would make this change, two months after the original order was issued, seems to be the following sentence added by the Amending Order:

> We recognize that some operators removing channels from the BST before this clarification may have read paragraph 98 of the *Going Forward Order* to allow BST rate adjustments based on the per channel adjustment factors from the table in section 76.922(g)(2), and previously in 47 C.F.R. § 76.922(e)(1994).[89]

Why would this fact, if true, be relevant? Presumably it is the Commission's job to tell cable operators how properly to read its rules, just as it tells franchising authorities how to do so

[88] This special exemption would not apply to Time Warner in the appeal referred to above, because Time Warner did not adopt the second methodology in its rate filing or its appeal. The company's rate filing and appeal took the frivolous position that *no* adjustment of the residual should be made. The second methodology appears to have been mentioned for the first time in Time Warner's Reply to the franchising authority's Opposition on the appeal.

in ruling on rate appeals. The only sense that can be given to the sentence quoted above appears to be that it represents a reappearance of the fallacy noted above in connection with à la carte tiers: the notion that an "honest mistake" by a cable operator is to be rewarded by allowing the mistake to stand.[90]

In fact, even if there were evidence that a "mistake" by the operator were honest (a factor that is certainly absent in the position that no adjustment need be made to the residual), this would have no bearing whatsoever on the *correct formula to arrive at a reasonable rate.* Rate regulation is simply not a matter of rewarding good intentions, much less intentions that are quixotically presumed to be good even in the face of contrary evidence.[91] It is a matter of protecting the subscriber against unreasonable rates; and allowing an operator's error to stand on the grounds that the operator *might conceivably have believed* it correct is a failure to prevent unreasonable rates and a failure to prevent evasions, both of which are violations of the Commission's express responsibilities under the statute.[92]

Correcting unreasonable rates is not a punishment. It merely achieves the statute's goal of protecting the subscriber. Correcting an erroneous assumption (even if it were made in good faith) by an operator is no more unfair than correcting a tax return in an audit to conform with

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[89] *Amending Order* at ¶ 2, amending paragraph 55 of the *NPRM&O*.

[90] *See* n.32 *supra* and accompanying text.

[91] *See* n.31 *supra* and accompanying text.

[92] It is noteworthy that the Commission does not seem to apply the same standard to the actions of local franchising authorities, its co-regulators. No case appears to exist in which the Commission approved a local community's action on the grounds that the community *might* have believed it was applying the Commission's rules correctly – much less one where the Commission approved a local action in the face of a finding that there was no apparent justification for the action other than to *avoid* the Commission's rules, as was true of the cable operators in the à la carte tier cases.

applicable law. If the Commission's intent in the Amending Order were to "let off the hook" cable operators who had misapplied the Commission's rules, it would be facilitating evasions, not preventing them as required by Congress.

B. Recommendations

The fundamental recommendation on this issue is simple: The Commission should clarify beyond any doubt that, programming costs aside, moving a channel out of (or into) the basic tier means moving that channel's *pro rata* share of the tier cost – the residual.

A second recommendation, however, flows from the way in which this issue illustrates the ability of cable operators to profit when the rate regulation system does not work. The issue of the residual in channel movement was presented in one appeal at the Commission. The same abuse of the Commission's rules, however, may have been embedded in any number of Time Warner's rate filings (not to mention those of other MSOs). If a cable operator is allowed to get away with a misapplication of the rules in every case that the local franchising authority does not catch, or lacks the resources to follow up on,[93] then the result will be an undeserved windfall to the operator, in the form of unreasonable rates.[94] The Commission should adopt a rule, and implement it in every rate order issued on appeal, requiring that an operator who is found to have misapplied the Commission's rules must go back and correct that error in *every* rate filing that contains that error. Only in this way can evasions be discouraged, by removing the unearned

[93] Particularly in the knowledge that a cable operator is fully prepared to waste the community's limited resources through frivolous appeals.

[94] Indeed, if this windfall were allowed, it would reduce the operator's net costs nationwide, and hence that decrease would need to be passed through at least annually in the form of rate *reductions*. *See* § 76.922(e)(2)(ii)(B).

benefit operators will otherwise derive from the ability to retain the fruits of their unappealed misuses of the rules.

V. THE COMMISSION'S RULES ON NATIONAL EQUIPMENT RATES HAVE PROVEN IMPRACTICABLE TO ENFORCE.

A. Problem

Prior to 1996, cable operators were required to use local system data and equipment basket costs specific to the franchise area to arrive at equipment rates. This approach ensured that subscribers would pay only the real costs of the equipment actually available to them in that system, and utilized costs that could often be checked against local government records, such as property tax filings and subscriber counts. The 1996 Act, however, allowed cable operators to use aggregate costs to arrive at equipment rates, rather than costs specific to the franchise area:

> The Commission shall allow cable operators, pursuant to any rules promulgated under subsection (b)(3), to aggregate, on a franchise, system, regional, or company level, their equipment costs into broad categories, such as converter boxes, regardless of the varying levels of functionality of the equipment within each such broad category. Such aggregation shall not be permitted with respect to equipment used by subscribers who receive only a rate regulated basic service tier.[95]

The Commission amended its rules to reflect such aggregation in June, 1996.[96] Unfortunately, in implementing the statutory change, the Commission in practice allowed operators to aggregate in such a way as to impede review by local franchising authorities. National data are of course inherently more difficult for a local community to validate than data

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[95] 47 U.S.C. § 543(a)(7)(A). The Commission had already ventured into this area in some of the "Social Contracts" it entered into with cable operators prior to 1996. *See, e.g., In re Social Contract for Time Warner*, Memorandum Opinion and Order, 11 FCC Rcd. 2788 (1995).

from the community itself. But this task became exponentially more difficult because of the ways in which operators were allowed to avoid providing accurate or even intelligible data.

The concept of reporting aggregate data seems to have been that this would make it easier for cable operators to assemble the necessary data, because the information could be aggregated at the same level where it was kept on the company's books. The Commission in fact required an operator to aggregate its data at the level where the operator kept the data.[97] The first annual Form 1205 filing by TCI (as it then was) under the new rules, however, in March 1997, ignored all of this and instead relied on a so-called sampling technique. TCI picked a subset of its systems that it claimed were representative, averaged out the data from those systems alone, and submitted the results of this operation (not the underlying data) to local franchising authorities. Curiously, in many communities the results were far higher than the previous year's unaggregated maximum permitted rates for the very same equipment, even though the aggregation was supposed to be revenue-neutral. For example, in one community the maximum permitted rate for addressable converters was $1.87 in 1996; in 1997 TCI claimed the same type of converter had increased in cost to $3.54, an increase of 89%.

This approach was not consistent with the Commission's rules, which required total aggregate data, not a sample. But the Commission failed to enforce those rules effectively against TCI. Initially, in reviewing TCI's appeals of numerous local rate orders, the Cable Bureau did comment that TCI had not submitted sufficient information to show that its

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[96] 47 C.F.R. § 76.923(a), (c), (f), (g), (m); *In re Implementation of Section 301(J) of the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd. 6778 (1996) ("*Equipment Aggregation Order*").

[97] *See Equipment Aggregation Order at* ¶ 17; *In re TCI Cablevision of Nevada, Inc., Appeal of Local Rate Order of Washoe County, NV; City of Sparks, NV; City of Reno, NV; Carson City, NV*, Consolidated Order, 11 FCC Rcd. 14,378, ¶ 13 (1996).

methodology represented a fair determination of costs, and noted that the burden had to be on TCI to do so, not on the city in question, which had no independent way of ascertaining TCI's costs.[98] However, on reconsideration, almost a year later, the Bureau vacated that section of the original order and remanded, apparently feeling that it *was* up to the city to show that TCI's methodology was incorrect.[99] As a result, it appears that in practice the Commission acceded to TCI's rewriting of the aggregation rules. The Commission acknowledged that the magnitude of the increase claimed by TCI using that methodology "may be a reason to closely examine supporting information,"[100] but it took no steps to do so, or to assist local communities in doing so.

In fact, a closer examination at the local level revealed significant facts. TCI stated in response to one local data request that its total pool of converter costs reflected the gross book value for all converters, including fully depreciated converters, whether or not they were currently in service. That gross book value also included purchase price allocations recorded at the time the system was acquired. By contrast, in local records such as the company's personal property tax return, the actual number of converters in service on the assessment date was used. There were thus peculiarities, if not irregularities, in the accounting treatment of such equipment that were more effectively revealed by comparison to local records, once it was possible to convert TCI's aggregate data to numbers that could in fact be so compared.

The Commission's failure to demand true aggregation supported by corporate financial books and records, rather than just an operator-selected sampling, means that there is no way of

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[98] *Richardson Order* at ¶¶ 26-30.

[99] *Richardson Reconsideration Order* at ¶¶ 24-25.

[100] *Id.* at ¶ 24.

knowing how the choice of sample communities may have been biased, whether the data used were consistent or sound, or whether the averaging methodology was valid. Yet, three years after the reconsideration order noted above, the Commission has taken no steps to address the problem.

It is possible that the Commission felt it could leave this matter to local authorities to resolve. If so, it underestimated the ability of operators to frustrate such resolution through "passive-aggressive" noncompliance. One financial expert working for local communities, for example, sought to investigate TCI's supporting data. The company's only response to specific questions was to ship large quantities of documents to the reviewer, without the requested explanations.[101] While it is indeed essential to have the underlying data, forcing the reviewer in effect to try and re-create TCI's results from this raw material, without detailed explanations and responses to specific questions, imposes enormous financial burdens on local franchising authorities and hence effectively prevents them from analyzing the data – a favorable result for the cable operator. Moreover, TCI impeded the effective or consistent application of any corrections by conditioning its submission of data on confidentiality commitments to prevent communities from sharing with others the details of their findings regarding national data, making it necessary for each community to re-invent the wheel.[102]

A different approach was adopted by Time Warner. This company "aggregated" data not by taking multi-jurisdictional information from the books at a level where it was kept in aggregate form, but rather by having fifty participating systems compile data specific to that locality and send the information to Time Warner's Connecticut office, where it was

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[101] Declaration of Garth Ashpaugh, CPA, attached as Exhibit 1 ("Ashpaugh Declaration").

"consolidated" into aggregate figures.[103] Review of the results indicated that the individual system data were not prepared using consistent methodologies to begin with, vitiating the Time Warner approach at the source. The franchising authority's financial expert spent seven months asking for detailed support for the 2001 aggregate numbers. During that time Time Warner's total response was one box of workpapers without cover letter or explanation. Finally, six weeks before the expiration of the twelve-month period allotted for review by the Commission, Time Warner delivered to the reviewer the original documents received by Time Warner's Connecticut office, without explanation, under a cover letter suggesting that the reviewer contact each of the fifty systems individually with any questions. (No contact information for these systems was provided with the letter.)[104]

Thus, the Commission's failure to establish firm, effective aggregation rules defeated the purpose of accurate regulation in one case where a nationwide approach *would* have been useful – the investigation and analysis of cross-jurisdictional aggregate data. The Commission declined to become involved and dropped the burden of investigation and analysis solely on local franchising authorities. The results illustrate both the inadequacy of the equipment aggregation rules and the urgent need for swift and effective enforcement tools to deal with cable operator intransigence.

B. Recommendations

One possible solution for the above problem would be for the Commission itself to review nationwide filings. To ensure that the accumulated expertise of prior rate review by local

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[102] Ashpaugh Declaration at ¶ 4.

[103] *Id.* at ¶ 5.

communities can be taken into account, however, such Commission review would need to incorporate cooperative features, such as mutual consultation with affected local communities or at the minimum a notice-and-comment process allowing input from franchising authorities and the public generally.

One approach that has not been tried in cable rate regulation is for the Commission to work together with local communities to unravel the intricacies of cable operator filings and arrive at a sound answer, rather than standing aloof from local attempts to apply the Commission's rules and then judging the results in the manner of an appeals court. Local communities seeking advice from the Commission on how to apply its rules, *prior* to issuing a rate order, have generally received little or no assistance or guidance. At times it appears the Commission regards local governments as coequal parties with the cable operators, to be treated as litigants, rather than as co-regulators seeking in good faith to apply the Commission's rules. A cooperative or partnership approach might be more helpful in arriving at accurate results.

It may be that the Commission would prefer not to get involved directly in the analysis of cable operator rate filings, even on a national basis. If so, a second alternative might be to require the cable operator who submits an aggregated filing to pay the cost of a third-party review of the filing and the supporting data by an independent accounting firm, selected and directed by the Commission, with input from local communities and the public as above. Presumably the cost savings an operator realizes through the aggregation of rate filings and consequent paperwork reduction would easily cover the cost of such a third-party review. The results could then be made available to all local franchising authorities that must rule on the individual filings.

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[104] *Id.*

In either case, it is important to reform the existing rules to prevent the sorts of abuses that have occurred to date. If the Commission intends to accept a sampling methodology, rather than an aggregation of *all* data in a category, it must specify the proper methodology for such sampling. It must require the operator to show that the methodology is revenue-neutral to the operator. More specifically, to the extent that the averaging involves a subsidy from some communities to others, the operator should be required to show which communities realize the benefit of this subsidy and which are providing it – so that there is some way to check on whether the averaging really is revenue-neutral.[105]

VI. THE COMMISSION'S APPROACH TO UNIFORM RATES RENDERS THE STATUTE POINTLESS AND ALLOWS ANTICOMPETITIVE PRACTICES.

A. Problem

The 1992 amendments to the Cable Act required an operator to have a uniform rate structure across the geographic area served by a cable system.[106] Initially, the Commission applied this requirement only where there was no effective competition.[107] Since the purpose of the uniformity requirement was to ensure that the benefits of any actual competition were applied throughout a cable system, that interpretation defeated the purpose of the statutory provision.[108] Thus, in early 1994 the Commission reconsidered and sought to apply the uniform rate provision

[105] *See Richardson Reconsideration Order* at ¶ 18 (some subsidies necessarily result from the aggregation method).

[106] 47 U.S.C. § 543(d).

[107] *Rate Order* at ¶ 421.

[108] *See* S. Rep. No. 102-92, at 76 (1991) ("Senate Report").

in all franchise areas, irrespective of effective competition.[109] The D.C. Circuit, however, disagreed, and restricted the uniform rate provision to areas lacking effective competition.[110] That result was confirmed by the 1996 Act amendments, which added language specifying that the provision did not apply "in any geographic area" where the operator is subject to effective competition.[111]

The Commission generally appears to have read "geographic area" to mean "franchise area." As a result, entire franchise areas have been deregulated where only a portion is subject to effective competition. This has allowed cable operators to charge supracompetitive prices in other portions, as noted above.[112] However, nothing requires the Commission to assume that a "geographic area" must be a "franchise area."

B. Recommendations

As recommended above, the Commission can adopt a rule that allows actual *competitive* rates in nearby areas to be used to establish regulated rates in the non-competitive regions.[113] Such a rule would comply with the D.C. Circuit's decision and the 1996 amendments, because no regulated rate would be set in those geographic areas where actual competition exists. It would not be an implementation of the uniform rate provision, § 543(d), strictly speaking. It would regulate rates only in those areas where effective competition did not exist. But it would

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[109] *Third Reconsideration Order* at ¶ 24.

[110] *See Time Warner Entertainment*, 56 F.3d at 190-92.

[111] 47 U.S.C. § 543(d)(1).

[112] *See* Section II.B.3 *supra*.

[113] *Id.*

effect the intent of Congress by protecting subscribers in the *non*-competitive areas from supracompetitive rates.

In addition, the Commission needs to create effective rules to deal with predatory pricing and other anticompetitive practices. The Commission has already made some statements taking a stand against predatory pricing, primarily with respect to MDU bulk contracts.[114] But the examples mentioned above show that the present rules do not adequately prevent such practices.[115] Both for the sake of consumers, whom it must protect under the Cable Act, and for the sake of protecting competition itself from suppression through anticompetitive practices, the Commission needs to make explicit rules to prohibit practices by incumbents that stifle competition, covering single-family residential subscribers as well as MDUs. The Commission should also develop enforcement methods, in cooperation with local communities, that will afford prompt relief to those victimized by such practices.

VII. THE COMMISSION'S INACTION ON "COMMERCIAL" CABLE RATES HAS ALLOWED OPERATORS TO DISCRIMINATE AMONG SUBSCRIBERS.

A. Problem

The status of the "commercial rates" issue illustrates a key fact about rate regulation. The Commission's presentation of the issue in the *NPRM&O* treats the matter as "unresolved."[116] In fact, however, cable operators routinely charge subscribers they deem to be "commercial" at rate levels far in excess of the maximum permitted rates set under the Commission's rules.

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[114] *See, e.g., Rate Order* ¶ 424; *Third Reconsideration Order* at ¶¶ 18, 20; *Effective Competition Order* at ¶¶ 106-112.

[115] *See* n.40 *supra*.

[116] *NPRM&O* at ¶ 30.

"Unresolved," to the industry, means that an operator can do as it chooses until the Commission specifically instructs it otherwise. Thus, when the Commission fails to resolve a problem, the result is not stasis; it is unrestrained abuse.

The statute directs the Commission to protect "subscribers" from unreasonable rates, without distinguishing between residential and commercial subscribers. Similarly, the Commission's actual present rules, as distinct from the questions raised by the Commission eight years ago, establish rules for subscriber rates without providing any exception for commercial subscribers. Local rate orders, too, generally do not provide commercial exceptions. And cable operators as a rule do not submit for rate review any separate "commercial" rates – only a single rate, presented as being calculated according to the Commission's regulations. It follows that, pending any Commission ruling to the contrary, cable operators must charge commercial subscribers the same regulated rates for basic service and equipment that they charge residential subscribers – *i.e.*, the one determined according to the FCC's rules to approximate the competitive rate.

Yet this is not the case. Subscribers alleged to be commercial are charged higher rates and may also be forced to accept other disadvantageous or anticompetitive terms to receive service. In the Portland, Oregon, metropolitan area, for example, commercial subscribers – both in multiple dwelling units (MDUs) and otherwise – are charged substantially higher rates than normal residential subscribers. These commercial subscribers are also required to sign multi-year contracts with the incumbent cable operator. The operators' exclusion of commercial rates from the process distorts the standard residential rate as well as allowing discrimination against so-called commercial subscribers, because neither the additional revenues operators extract from such subscribers, nor the real subscriber count, are properly incorporated in the rate calculations.

Various arguments may be made regarding commercial-residential discrimination. Some may suggest, for instance, that a sports bar can reasonably be charged higher rates than a home subscriber, on the grounds that the bar makes money because its customers can watch TV while imbibing or eating. The same may not be true, however, of a pediatrician's office that provides a television merely as an amenity in the waiting room. And the rationale appears to function quite differently in the case of, say, a trucking company that wishes to have the Weather Channel available for updates. It is clear that the vague term "commercial" may cover a multitude of possible uses of cable service by many types of cable subscribers.

In all these various cases, of course, the cable operator's basic tier costs are likely to be unchanged: the sports bar's hookup imposes no greater burden on an operator's cable system than the residential outlet.[117] So the industry's claim to charge higher rates to commercial subscribers does not appear to be based on costs.

There are more broadly disturbing aspects to the notion that a cable operator can discriminate among subscribers who receive the same service from the operator, based on the use they make of that service once received. To what extent are subscribers' First Amendment interests threatened by an assumption that a cable operator can monitor their activities and manipulate their pricing based on how they use the service? Should the Commission allow cable operators to impose an essentially ungoverned "private regulation" scheme on their customers? It is already established that cable operators have an interest in controlling and manipulating the

[117] Indeed, when more people see the TV screen, this gives wider exposure to the cable operator's products – particularly if the operator's logo appears in ads or other announcements – and thus provides a sort of free advertising ("Say, I'd like to get this channel at home too . . .").

way their subscribers are allowed to access information.[118] Allowing operators to make judgments about what subscribers are "commercial" and to charge them prices above the regulated (presumably competitive) rate approaches much closer to a federally-blessed private regulation regime than would be wise.

Yet, whether these arguments appear convincing or not, the fact is that operators are charging subscribers rates in excess of the maximum reasonable rates set according to Commission rules. And the Commission, having confused the issue by suggesting that it might someday adopt rules on separate commercial rates (a fact frequently restated, or overstated, by operators to local franchising authorities), has taken no steps to prevent this widespread, ten-year facial violation of the Commission's rules.

B. Recommendations

Unless and until the Commission adopts separate regulated rates for basic service and equipment for commercial subscribers, consistent with the congressional mandate of the statute, the Commission should clarify that operators must charge the same rates to commercial as to residential subscribers. If the Commission finds that there are cost differences in operators' provision of service to commercial and residential subscribers, then it may wish to allow for exceptions to this rule insofar as an operator can show the existence and amount of this cost.[119]

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[118] *See, e.g.,* Christopher Stern, *Comcast Halts Tracking of Its Subscribers; Privacy Activists Had Criticized Practice of Collecting Data on Visits to Web Sites,* Washington Post, Feb. 14, 2002, at E4; Brigitte Greenberg, *Privacy Complaints Prompt Change in Comcast Web Policy*, Communications Daily, Feb. 14, 2002.

[119] If an operator alleges any difference in terms of programming costs, it should be required to show that this difference results from a legitimate arm's-length transaction with a programmer. Otherwise, the existing affiliations between programmers and cable operators could provide an easy avenue for collusive arrangements designed to enable operators to charge higher commercial rates. Operators should also be required to show that higher commercial

To allow enforcement of this rule, the Commission should permit any subscriber who has been discriminated against on "commercial rate" grounds to file a complaint directly with the Commission for relief, with a decision guaranteed within a short, specified time.[120] Alternatively, such a complaint could be filed with the local franchising authority, with the cable operator required (as noted above) to comply with a local rate order on the complaint unless and until the order was stayed or reversed by the Commission, and fines or forfeitures established for failure to do so.

VIII. CONCLUSION

As noted above, these Comments do not attempt to produce a complete catalogue of all the problems with, or potential improvements to, the rate regulation rules. It is to be hoped that the issues specifically discussed may serve as useful examples to assist the Commission in identifying and correcting other problems, and in evaluating the suggestions that will be made by the cable industry to minimize the effectiveness of the Commission's rules.

One fact that becomes evident from the above discussion must be reemphasized. The Commission *cannot* rely on the industry to police itself, to voluntarily accept reasonable rates, or to comply with the "spirit" of the Commission's rules in good faith. History shows otherwise. In other words, if the Commission does not enforce sound rate rules, rates *will* be unreasonable. It follows that, unwelcome as the task of dealing with rate rules may be, the statutory mandate

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revenues were not used either by the Commission, in its rules, or by the operator, in its Form 393 and 1200 filings, to establish the initial regulated rates.

[120] To date, Commission rulings on rate appeals have provided an outstanding example of the maxim that "justice delayed is justice denied." For example, the Commission's appeal decision regarding the Fairfield Ohio system represented a three-year delay. *In re TCI Cablevision of Ohio, Inc., Appeal of Local Rate Order of the City of Fairfield, Ohio,*

means that the Commission must take affirmative steps to stop evasions and to make sure its rules work as they should.

Similarly, it is essential for the Commission to realize that enforcing reasonable rates is not a punishment. Being forced to charge a reasonable rate is not a burden on a cable operator. Rather, rate rules are merely intended to reproduce an approximation of what the cable operator *would* have to do in any case if there were real, working competition. Thus, it would be inappropriate to justify allowing any unreasonable rates on the grounds that the cable operator should not be "punished" for "honest mistakes." (If the Internal Revenue Service took that approach, few taxpayers would ever pay interest or penalties for errors on tax returns.) Even if mistakes are honest, they are *mistakes*; and legitimizing them automatically means allowing unreasonable, supracompetitive rates for subscribers.

The Commission may not, consistent with its legal obligations, permit its rules to be misused or abused. It may correct such misuses kindly, if it believes an honest mistake has been made in a particular individual case because a rule was truly confusing and Commission guidance was not forthcoming; but it must correct them.

For the reasons indicated above, the Bureau should revise and enforce its rate rules as recommended herein.

Respectfully submitted,

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Nicholas P. Miller
Frederick E. Ellrod III
Mitsuko R. Herrera
Miller & Van Eaton, P.L.L.C.
1155 Connecticut Avenue, N.W. #1000

Memorandum Opinion and Order, 13 FCC Rcd. 17,303, ¶ 1 (1998) (rate order adopted June 12, 1995, appeal filed July 12, 1995, appeal decision issued July 1, 1998).

Washington, D.C. 20036-4306
202-785-0600

Counsel for the National Association of Telecommunications Officers and Advisors, the National League Of Cities, and the Miami Valley Cable Council

November 4, 2002

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EXHIBIT 1
DECLARATION OF GARTH ASHPAUGH, CPA

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Revisions to Cable Television Rate Regulations	)	MB Docket No. 02-144
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 92-266
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 93-215
Adoption of a Uniform Accounting System for the Provision of Regulated Cable Service	)	CS Docket No. 94-28
Cable Pricing Flexibility	)	CS Docket No. 96-157

DECLARATION OF GARTH ASHPAUGH IN SUPPORT OF THE COMMENTS OF THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS, THE MIAMI VALLEY CABLE COUNCIL

I, Garth T. Ashpaugh, declare as follows:

1. I submit this declaration in support of the comments submitted by the National Association of Telecommunications Officers and Advisors, *et. al*, in the above-captioned matter. I am fully competent to testify to the facts set forth herein, and if called as a witness, I would testify to them.

2. I have served as President and Member of Ashpaugh & Sculco, CPAs, PLC, since December 1999. I am licensed as a Certified Public Accountant in the states of Florida and Missouri. I previously served as an Audit Supervisor for the Missouri Public Service Commission. I earned my Bachelor's of Science in Business Administration from the University of Missouri in 1977.

3. I have over twenty years of experience in cable and utility rate regulation matters. Since 1992, I have worked with over 200 cities and counties in cable-related matters. I have performed financial analyses and audits of cable operator rate and equipment filings, renewal proposals, and transfer applications in Arizona, California, Florida, Kentucky, Maryland, Michigan, Minnesota, New Mexico, New York, Ohio, Pennsylvania, Tennessee, Texas, Virginia, Wisconsin and Wyoming. I have also assisted clients in evaluating mergers and purchases including Kansas City Power and Light and UtiliCorp, Baltimore Gas and Electric Company and Potomac Electric Power Company, SBC Media and Prime Communications, Prime Communications and Comcast, AT&T Communications and Tele-Communications Inc., and AT&T Broadband and Comcast Communications.

4. I have reviewed national equipment rate filings submitted by AT&T and Time Warner. In both situations, the operators were reluctant to work with the local communities to resolve rate regulation issues. For example, all of the AT&T equipment rate information was calculated by the AT&T Denver office. In response to specific questions that I submitted on behalf of a single community, AT&T sent thousands of documents which then had to be reviewed by the community at substantial expense. In addition, like many operators, AT&T required the community to keep the reviewed information confidential. When AT&T was notified of certain errors or corrections, AT&T did not correct similar filings that it had

submitted to other communities. Because of the confidentiality agreement, the reviewing community could not share information with other communities. Thus, every AT&T-served community with rate regulation authority was in effect required to perform separate, expensive reviews of substantially similar documents to ascertain information that AT&T should have provided initially.

5. Time Warner's 2001 FCC Form 1205 equipment filings provide another example of an operator's attempt to prevent a community from reviewing aggregate equipment rate calculations. Time Warner has each of its fifty participating systems compile data specific to each area and send the information to Time Warner's Connecticut office. There it is "consolidated" with minor changes to reflect efforts at consistency. However, my review revealed that there is very little consistency in the methodologies of the 50 systems. Some systems properly allocated costs to the FCC Form 1205, *e.g.*,, the portion of installation costs properly allocable to subscribers, and then allocated costs from FCC Form 1205 to the equipment basket. Other systems did not calculate what portion of costs were not properly allocable to FCC Form 1205, *e.g.*, the cost of installation wiring on the cable operator side of the cable wiring demarcation point, and instead improperly allocated 100% of costs to the equipment basket. Some systems included capitalized installations in the equipment basket, while others did not. Given the lack of uniform methodology, Time Warner's consolidated aggregate equipment rate calculations are unreliable at best.

6. After seven months of asking for Time Warner for detailed support and not receiving any responses to any of the community's questions (other than a box of work papers with no cover letter and no explanations), Time Warner delivered to my office, without any further notice, the original documents received by the Connecticut office concerning the 2001

consolidated FCC Form 1205 filing. The cover letter stated if I had any further questions I should contact each of the fifty systems individually. I was not provided any contact information for the fifty systems – no names, phone numbers or e-mail addresses. As there were at the time only six weeks left within the community's twelve-month review period, Time Warner had effectively run out the clock on the community's ability to challenge Time Warner's questionable national equipment rate averaging practices.

7. In addition, in Time Warner's 2002 FCC Form 1205 filing for the Miami Valley [Ohio] Cable Council, Time Warner filed a regional equipment rate filing with substantially higher equipment rates as compared to Time Warner's 2002 national FCC Form 1205 filing. There is no evidence that Time Warner excluded the higher Miami Valley regional equipment rates in preparing its national average equipment rates. Thus, when the national equipment rate filing is provided to other communities, those communities must pay higher rates because of the inclusion of certain higher regional rates, yet subscribers living in communities in regions with higher regional rates are not receiving the benefit of lower, nationally averaged rates.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief, and that this declaration was executed on November 3, 2002, at Winter Park, Florida.

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Garth T. Ashpaugh

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